No. 15-145

Title:	Husky International Electronics, Inc., Petitioner
	v.
	Daniel Lee Ritz, Jr.
Docketed:	July 31, 2015
Lower Ct:	United States Court of Appeals for the Fifth Circuit
Case Nos.:	(14-20526)
Decision Date:	May 22, 2015

Questions Presented

--Date--	----Proceedings and Orders----------
Jul 30 2015	Petition for a writ of certiorari filed. (Response due August 31, 2015)
Aug 28 2015	Order extending time to file response to petition to and including September 30, 2015.
Sep 30 2015	Brief of respondent Daniel Lee Ritz, Jr. in opposition filed.
Oct 13 2015	Reply of petitioner Husky International Electronics, Inc. filed. (Distributed)
Oct 14 2015	DISTRIBUTED for Conference of October 30, 2015.
Nov 2 2015	DISTRIBUTED for Conference of November 6, 2015.
Nov 6 2015	Petition GRANTED.
Dec 21 2015	Joint appendix filed. (Statement of costs filed)
Dec 21 2015	Brief of petitioner Husky International Electronics, Inc. filed.
Dec 23 2015	SET FOR ARGUMENT ON Tuesday, March 1, 2016
Dec 23 2015	Brief amicus curiae of National Association of Bankruptcy Trustees filed.
Dec 28 2015	Brief amicus curiae of United States filed.
Dec 28 2015	Brief amici curiae of Bankruptcy Law Professors filed.
Jan 5 2016	Record requested from the U.S.C.A. 5th Circuit.
Jan 5 2016	Records from the U.S.C.A. 5th Circuit, as well as U.S.D.C. Southern Dist. of Texas is electronic and located on PACER.
Jan 15 2016	CIRCULATED.
Jan 15 2016	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
Jan 20 2016	Brief of respondent Daniel Lee Ritz, Jr. filed. (Distributed)
Jan 25 2016	Brief amicus curiae of National Association of Consumer Bankruptcy Attorneys filed. (Distributed)
Jan 25 2016	Brief amici curiae of Professors Richard Aaron, et al. filed. (Distributed)
Jan 27 2016	Brief amicus curiae of G. Eric Brunstad, Jr. filed. (Distributed)
Feb 18 2016	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
Feb 19 2016	Reply of petitioner Husky International Electronics, Inc. filed. (Distributed)
Mar 1 2016	Argued. For petitioner: Shay Dvoretzky, Washington, D. C., and Sarah E. Harrington, Assistant to the Solicitor General, Department of Justice, Washington, D. C. (for United

States, as amicus curiae.) For respondent: Erin E. Murphy, Washington, D. C.

May 16 2016 Judgment REVERSED and case REMANDED. Sotomayor, J., delivered the opinion of the Court, in which Roberts, C. J., and Kennedy, Ginsburg, Breyer, Alito, and Kagan, JJ., joined. Thomas, J., filed a dissenting opinion

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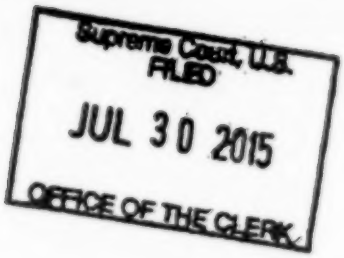

No. 15-___

IN THE

Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC.

Petitioner,

v.

DANIEL LEE RITZ, JR.,

Respondent,

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

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July 2015

QUESTION PRESENTED

The Bankruptcy Code bars the discharge of "any debt for money obtained by [1] false pretenses, [2] a false representation, or [3] actual fraud." 11 U.S.C. § 523(a)(2)(A). The First and Seventh Circuits have held that the "actual fraud" bar applies where an individual debtor deliberately obtains money through a fraudulent-transfer scheme that is actually intended to cheat a creditor. But in an acknowledged circuit split, the Fifth Circuit held as a matter of law that there can be no "actual fraud" unless the debtor makes a false representation to the creditor. This decision creates a roadmap for dishonest debtors to cheat creditors through deliberate fraudulent-transfer schemes, and then to escape liability through discharge in bankruptcy. The question presented is:

Whether the "actual fraud" bar to discharge under Section 523(a)(2)(A) of the Bankruptcy Code applies only when the debtor has made a false representation, or whether the bar also applies when the debtor has deliberately obtained money through a fraudulent-transfer scheme that was actually intended to cheat a creditor.

LIST OF PARTIES

The parties in the court below were Husky International Electronics, Inc., and Daniel Lee Ritz, Jr.

RULE 29.6 DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, Petitioner Husky International Electronics, Inc., discloses that it is a privately held corporation that has no parent corporation and no publicly traded stock, and no publicly held company owns more than 10% of its stock.

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PETITION FOR WRIT OF CERTIORARI

Petitioner respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit.

OPINIONS BELOW

The opinion of the Fifth Circuit is reported at 787 F.3d 312 and set forth at Pet. App. 1a. The opinion of the district court is reported at 513 B.R. 510 and set forth at Pet. App. 21a. The opinion of the bankruptcy court is reported at 459 B.R. 623 and set forth at Pet. App. 78a.

JURISDICTION

The judgment of the court of appeals was entered on May 22, 2015. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 523 of the Bankruptcy Code, 11 U.S.C. § 523, provides:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

STATEMENT OF THE CASE

A. Legal Background

Congress intended the Bankruptcy Code to provide a fresh start for "the honest but unfortunate debtor." *Brown v. Felsen*, 442 U.S. 127, 128 (1979) (quotation marks and citation omitted). In keeping with that purpose, the Code provides relief for individual debtors but also provides that they may not discharge debts for money obtained through dishonest or fraudulent means. Specifically, as pertinent here, "a discharge" in bankruptcy "does not discharge an individual debtor from any debt for money to the extent obtained by false pretenses, a false representation, or actual fraud." 11 U.S.C. § 523(a)(2)(A); *see also id.* §§ 727(b), 1328(a)(2) (making the discharge exceptions of § 523 applicable to individual bankruptcies under Chapters 7 and 13).

B. Factual Background

As the Fifth Circuit explained, "[t]he facts underlying this [case] are straightforward." Pet. App. 2a.

Respondent Daniel Lee Ritz, Jr., was at all relevant times the partial owner of Chrysalis Manufacturing Corporation. Under Ritz's control, Chrysalis made a series of purchases from Petitioner Husky International Electronics, Inc., between 2003 and 2007. Husky delivered the goods, but Chrysalis never paid for them, leaving a total unpaid debt of $163,999.38. Pet. App. 2a.

While this debt was outstanding, Ritz (who had financial control of Chrysalis) fraudulently transferred over a million dollars from Chrysalis to at least seven other entities that he owned and

controlled. *See* Pet. App. 2a. Chrysalis was insolvent during this time, was not paying its debts as they became due, and did not receive reasonably equivalent value in exchange for the transfers. Pet. App. 3a.

In May 2009, Husky sued Ritz in federal district court to hold him personally liable for the debt of $163,999.38 because he orchestrated and personally benefited from the fraudulent-transfer scheme. Pet. App. 3a. Shortly thereafter, and before Husky's claim could be adjudicated, Ritz filed a voluntary petition for bankruptcy under Chapter 7. Among other things, his petition sought to discharge the personal debt that he owed to Husky as a result of his receiving funds from Chrysalis in the fraudulent-transfer scheme. Pet. App. 3a.

C. The Proceedings Below

In March 2010, Husky initiated an adversary proceeding in the bankruptcy court, arguing that Ritz's debt to Husky was non-dischargeable under the "actual fraud" exception of 11 U.S.C. § 523(a)(2)(A). Specifically, Husky contended that Ritz defrauded Husky by transferring funds from Chrysalis to his other entities in a deliberate attempt to thwart Husky's effort to collect the debt it was owed. As a result of his orchestrating and personally benefiting from this scheme, Ritz personally owed Husky a "debt . . for money obtained by actual fraud." *Id.*

1. In August 2011, the bankruptcy court made findings of fact and conclusions of law. Pet. App. 78a. The court found that the transfers "orchestrat[ed]" by Ritz were not made for reasonably equivalent value,

and that Husky suffered damages in the full amount of $163,999.38. Pet. App. 82a. The court also determined that Ritz was "not a credible witness" due to his "blatantly contradictory" and "evasive[]" testimony, which was at times "disingenuous, if not downright misleading," as well as his "selective" inability to remember certain information when questioned under oath on the witness stand. Pet. App. 83a-85a.

Nevertheless, the bankruptcy court held as a matter of law that Ritz's conduct did not constitute "actual fraud" under Section 523(a)(2)(A) for the sole reason that he did not make any "false representation" to Husky in the course of his fraudulent-transfer scheme. Pet. App. 92a.[1]

2. Husky appealed to the district court. That court found that "[b]ecause Ritz caused Chrysalis to be used for the purpose of perpetrating and did perpetrate an actual fraud on its creditors primarily for Ritz's direct personal benefit, i.e., he drained Chrysalis of funds and fraudulently transferred those funds to other entities under his control and/or ownership, [Texas law] applies here to impose liability on Ritz, individually." Pet. App. 68a-69a.

Nevertheless, the court went on to hold that, as a matter of federal law, Ritz's debt to Husky was dischargeable in bankruptcy notwithstanding Section 523(a)(2)(A). The dispositive legal issue, according to the district court, was that Husky failed to allege a misrepresentation by Ritz, and therefore his conduct

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[1] For the same reason, the bankruptcy court held that Ritz had not committed "actual fraud" under Texas law. Pet. App. 92a.

could not constitute "actual fraud" within the meaning of Section 523(a)(2)(A). Pet. App. 73a-74a.

3. The Fifth Circuit affirmed, holding that a false representation by the debtor "is a necessary prerequisite for a showing of 'actual fraud' under Section 523(a)(2)(A)." Pet. App. 17a. The court acknowledged that the Seventh Circuit had reached the opposite conclusion in *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000) (Posner, J.), which held that "'actual fraud' under [Section 523(a)(2)(A)] 'is not limited to misrepresentations and misleading omissions,'" but also includes deliberate fraudulent-transfer schemes. Pet. App. 7a (quoting 217 F.3d at 893). But the Fifth Circuit nonetheless "decline[d]" to "adopt[] the interpretation of Section 523(a)(2)(A) endorsed [in] *McClellan*." Pet. App. 9a.

To support its narrow reading of "actual fraud," the Fifth Circuit relied heavily on this Court's decision in *Field v. Mans*, 516 U.S. 59 (1995), which addressed "the level of reliance that § 523(a)(2)(A) requires a creditor to demonstrate" in order to bar discharge where the debtor has allegedly committed fraud by misrepresentation. *Id.* at 63. *Field*'s analysis began from the premise that the terms "'false pretenses, a false representation, or actual fraud,' carry the acquired meaning of terms of art" and "imply elements that the common law has defined them to include." *Id.* at 69. Thus, in determining the level of reliance necessary to trigger the discharge exception in a case of alleged fraudulent misrepresentation, *Field* "look[ed] to the concept of 'actual fraud' as it was understood in 1978 when that language was added to § 523(a)(2)(A)." *Id.* at 70. For example, the Court cited "the Restatement (Second) of Torts

(1976)," and "the edition of Prosser's Law of Torts available in 1978," both of which defined "justifiable reliance" as an essential element of fraud by misrepresentation. *Id.* at 70-71.

The Fifth Circuit acknowledged that *Field* did not "directly address[] the issue" of whether "actual fraud" requires a misrepresentation—indeed, the *Field* Court had no reason to consider other possible forms of fraud because "the facts underlying *Field* involved a misrepresentation." Pet. App. 10a-11a. But the Fifth Circuit nevertheless stated that "[the] opinion in *Field* appeared to assume that a false representation is necessary to establish 'actual fraud.'" Pet. App. 10a (citing *Field*, 516 U.S. at 68, 79).

The Fifth Circuit also cited circuit precedent and other considerations to support its interpretation of Section 523(a)(2)(A). *See infra* Part III. The court acknowledged that Section 523(a)(2)(A) refers separately to both "actual fraud" and "false representation," and that the court's reading of the statute might "render[] the latter phrase redundant." Pet. App. 14a. But the court reasoned that the canon of "giv[ing] effect, if possible, to every word Congress used" is not "inviolable." Pet. App. 14a (citation omitted). The court also suggested that the statute's separate reference to "actual fraud" may not have been "intend[ed] to create a separate basis for dischargeability," but rather "only to codify 'the limited scope of the fraud exception' as expressed in case law 'interpret[ing] "fraud" to mean actual or positive fraud rather than fraud implied by law.'" Pet. App. 15a (citation omitted).

The court further surmised that other provisions of the Bankruptcy Code "may be rendered redundant" by *McClellan*'s understanding of "actual fraud." Pet. App. 16a (citing 11 U.S.C. §§ 727(a)(2), 523(a)(4), 523(a)(6)). And at the end of its analysis, the court observed that, "to the extent Section 523(a)(2)(A) is ambiguous, '[e]xceptions to discharge should be construed in favor of debtors.'" Pet. App. 16a (quoting *Fezler v. Davis*, 194 F.3d 570, 573 (5th Cir. 1999)).

Thus, because the court concluded that "actual fraud" requires a false representation, and "the parties agree[d]" that Ritz's fraudulent-transfer scheme involved no such misrepresentation, the court held that Section 523(a)(2)(A) did not bar the discharge of Ritz's debt to Husky. Pet. App. 17a.

This petition for certiorari followed.

REASONS FOR GRANTING THE PETITION

This Court should grant certiorari for three reasons. *First*, there is a square and acknowledged circuit split on the question presented, with extensive opinions by the First and Seventh Circuits disagreeing with a thorough opinion by the Fifth Circuit. *Second*, this issue is important because it recurs throughout the lower courts, and the position espoused by the Fifth Circuit subverts the equitable purposes of the Bankruptcy Code and turns bankruptcy law into an engine for fraud. *Third*, the decision below is wrong because it misinterprets the statutory language and fails to recognize that the common-law concept of "actual fraud" codified in Section 523(a)(2)(A) encompasses deliberate fraudulent-transfer schemes that are actually intended to cheat a creditor.

I. THE CIRCUITS HAVE EXPRESSLY DIVIDED ON THE MEANING OF "ACTUAL FRAUD" UNDER SECTION 523(a)(2)(A)

Certiorari should be granted because the courts of appeals have openly acknowledged a circuit split on the question presented. *See* Sup. Ct. Rule 10(a). The Fifth Circuit has held categorically that a false representation is a necessary element of "actual fraud" under Section 523(a)(2)(A). By contrast, the First and Seventh Circuits have held that "actual fraud" occurs when a debtor participates in a deliberate fraudulent-transfer scheme with intent to cheat a creditor, even without a false representation.

1. In the decision below, the Fifth Circuit squarely held that a false representation "is a necessary prerequisite for a showing of 'actual fraud' under Section 523(a)(2)(A)." Pet. App. 17a. That holding was the sole basis for the court's decision that Section 523(a)(2)(A) does not bar the discharge of Ritz's debt to Husky. Pet. App. 17a.

At the same time, as described above, the court expressly acknowledged that the Seventh Circuit had reached the opposite conclusion on the same issue in *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000), which involved allegations of a similar fraudulent-transfer scheme. The court addressed *McClellan*'s reasoning at length. *See* Pet. App. 7a-16a.

2. In *McClellan*, the Seventh Circuit confronted the same type of situation present here: The debtor's brother owed $100,000 to a creditor for the purchase of ice-making machinery. When the brother became insolvent, he "sold" the machinery to his sister, the debtor, for $10. She then sold the machinery for

$160,000, spent the money, and filed for Chapter 7 bankruptcy seeking to discharge all of her debts. The creditor sued to hold her personally liable for the debt as a result of her participation in the fraudulent-transfer scheme, and also sought to bar her from discharging the debt in bankruptcy under Section 523(a)(2)(A). *See McClellan*, 217 F.3d at 892.

Despite the lack of any false representation, the Seventh Circuit held that Section 523(a)(2)(A) bars a discharge if the debtor's participation in the fraudulent-transfer scheme "involved an *actual* fraud," in the form of a "*deliberate*[] attempt[] to thwart [the creditor's] effort to collect the debt due him." *McClellan*, 217 F.3d at 894. The court explained that when a person deliberately obtains money through a fraudulent-transfer scheme, she incurs a debt to the creditor for the transferred amount, and thus both the money and the corresponding debt are "obtained by" actual fraud. *Id.* at 894-95. The court therefore concluded that "misrepresentation is not the only form that fraud can take or the only form that makes a debt nondischargeable" under Section 523(a)(2)(A). *Id.*

The court explained that "[n]o learned inquiry into the history of fraud is necessary to establish that it is not limited to misrepresentations and misleading omissions." *Id.* at 893. Although "[n]o definite and invariable rule can be laid down," "'fraud includes all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated.'" *Id.* (citation omitted). The court further reasoned that fraudulent transfers "may [involve] either constructive or actual" fraud: The fraud "is constructive if the only evidence of it is the inadequacy of the consideration," but "it is

actual," and thus non-dischargeable as "actual fraud" under Section 523(a)(2)(A), "if the debtor intended by the transfer to hinder his creditors." *Id.* at 894 (emphasis added, citations omitted).

Because it holds that "actual fraud" encompasses fraudulent transfers intended to cheat creditors even without any false representation, the Seventh Circuit's decision in *McClellan* squarely conflicts with the Fifth Circuit's decision below.

3. Five weeks after the Fifth Circuit issued the decision below, the First Circuit decided *Sauer, Inc., v. Lawson*, No. 14–2058, 2015 WL 3982395 (July 1, 2015), in which it rejected the Fifth Circuit's position. *Id.* at *1 n.1 (acknowledging that "the Fifth Circuit, in a post-argument decision, has disagreed with *McClellan* and our analysis here").

The First Circuit framed its holding as follows:

> We are asked to resolve this narrow but significant issue of whether a debt that is not dischargeable in Chapter 13 bankruptcy as a debt for money or property 'obtained by actual fraud' extends beyond debts incurred through fraudulent misrepresentations to also include debts incurred as a result of knowingly accepting a fraudulent conveyance that the transferee knew was intended to hinder the transferor's creditors. We join the Seventh Circuit in concluding that it does.

Id. at *1 (quoting 11 U.S.C. § 523(a)(2)(A)).

Once again, the facts of *Lawson* are materially identical to those of this case and *McClellan*. The

debtor's father originally owed Sauer a debt of over $160,000. He sought to avoid paying the debt through a fraudulent-transfer scheme involving a shell company controlled by his daughter, who ultimately transferred $80,000 to herself. The daughter subsequently filed for Chapter 13 bankruptcy. Sauer sued to hold her personally liable for the debt as a result of her participation in the fraudulent-transfer scheme, and also sought to bar her from discharging the debt in bankruptcy under the "actual fraud" prong of Section 523(a)(2)(A). *See id.* at *1-2.

The First Circuit held that "'actual fraud' is not limited to fraud effected by misrepresentation," but also "includes fraudulent conveyances that are 'intended to hinder [the relevant] creditors.'" *Id.* at *4 (quoting *McClellan*, 217 F.3d at 894). Like the Fifth Circuit, the First Circuit followed the methodology of this Court's decision in *Field* by looking to the Restatement (Second) of Torts to discern the meaning of "actual fraud" when Congress enacted that language in 1978. *Compare id.* at *3 (citing *Field*, 516 U.S. at 70) *with* Pet. App. 10a-11a. But unlike the Fifth Circuit, the First Circuit read the Restatement to indicate that some fraudulent transfers *did* qualify as a type of "actual fraud" at common law. Specifically, the court found that deliberate participation in a fraudulent-transfer scheme was a recognized form of "fraudulent interference with [property rights]," because it involves "'intentionally depriv[ing] another of his legally protected property interest or caus[ing] injury to the interest" through "conduct [that] is generally culpable and not justifiable under the circumstances.'" *Lawson*, 2015 WL 3982395 at *3

(quoting Restatement (Second) of Torts § 871). The First Circuit's decision thus not only conflicts with the Fifth Circuit's decision in its reasoning and result, but the two courts reached their conflicting decisions based on the very same interpretive methodology that this Court set forth in *Field*.

The First Circuit also noted that Section 523(a)(2)(A) "explicitly lists both 'actual fraud' and 'false representations' as grounds for denying a discharge." *Id.* at *4 (citation omitted). "[A]gree[ing] with the Seventh Circuit," the court concluded "that this distinction must have meaning, and that the most obvious meaning is the one that comports with common law understanding: 'actual fraud is broader than misrepresentation.'" *Id.* (quoting *McClellan*, 217 F.3d. at 893).

Finally, the First Circuit found support for its conclusion by tracing the history of the "actual fraud" exception from the Bankruptcy Act of 1867 through the Bankruptcy Act of 1898 and finally to the Bankruptcy Act of 1978. *See id.* at *4-5. The court concluded that, throughout this history, "the fraud exception to discharge," which is now "codified at § 523(a)(2)(A)," has "bar[red] from discharge debts incurred through knowing and intentional receipt of fraudulent conveyances since 1867." *Id.* at *5. In the absence of "'a clear indication that Congress intended a departure,'" the court declined to "erode [that] past bankruptcy practice." *Id.* at *7 (citation omitted).

* * *

McClellan, *Lawson*, and the decision below create a clear and acknowledged circuit split on whether the

"actual fraud" discharge bar of Section 523(a)(2)(A) applies when a debtor deliberately participates in a fraudulent-conveyance scheme, even absent a misrepresentation. This case—in which the Fifth Circuit held that the "actual fraud" exception to discharge under Section 523(a)(2)(A) was inapplicable solely because of the undisputed lack of a misrepresentation by the debtor to the creditor—presents an ideal vehicle in which to consider the dispositive legal issue that has divided the circuits.

II. THE QUESTION PRESENTED IS IMPORTANT BECAUSE THE ISSUE RECURS THROUGHOUT THE LOWER COURTS, AND THE FIFTH CIRCUIT'S APPROACH TRANSFORMS INDIVIDUAL BANKRUPTCY INTO AN ENGINE FOR FRAUD

Certiorari should also be granted because the question presented is "an important question of federal law that has not been, but should be, settled by this Court," Sup. Ct. R. 10(c), and it recurs throughout the lower courts.

The First Circuit recognized that the scope of the "actual fraud" bar to discharge in individual bankruptcy is a "significant issue" and a "matter of public importance" that goes to the core of the equitable purposes of the Bankruptcy Code. *Lawson*, 2015 WL 3982395, at *1, *2. And the Seventh Circuit aptly summarized the stakes:

> The two-step routine [alleged]—in which Debtor A transfers valuable property to B for nothing in order to keep it out of the hands of A's creditor and B then

> declares bankruptcy in an effort to shield herself from liability for having colluded with A to defeat the rights of A's creditor—is as blatant an abuse of the Bankruptcy Code as [one] can imagine. It turns bankruptcy into an engine for fraud.

217 F.3d at 893. Congress did not intend to reward such fraudulent conduct through the Bankruptcy Code. To the contrary, by the plain terms of Section 523(a)(2)(A), "Congress concluded that preventing fraud is more important than letting defrauders start over with a clean slate." *Id.* (citation and quotation marks omitted).

This issue commonly arises in individual bankruptcy cases. Even beyond the split at the circuit level, the recurrence of the issue has led to disarray in the lower courts, which generally "disagree regarding whether 'actual fraud' within the meaning of § 523(a)(2)(A) means more than, or can be established other than by proving the existence of, a 'false representation.'" *In re Ali*, 321 B.R. 685, 690 (Bankr. W.D. Pa. 2005) (collecting cases). Bankruptcy appellate panels in the Sixth and Tenth Circuits have followed *McClellan* in holding that not all forms of "actual fraud" require a showing of a misrepresentation. *See In re Vickery*, 488 B.R. 680, 691 (10th Cir. BAP 2013) (holding non-dischargeable a debt resulting from a fraudulent transfer in the absence of any misrepresentation); *In re Vitanovich*, 259 B.R. 873, 877 (6th Cir. BAP 2001). Many bankruptcy courts around the country agree.[2] But

[2] *See, e.g., In re Pollan*, 2014 WL 2756527, at *3 (Bankr. D. Kan. 2014); *In re Williams*, 2011 WL 11718019 (Bankr. N.D. Ga.

some bankruptcy courts have instead taken the approach endorsed by the Fifth Circuit here, requiring a false representation for a finding of "actual fraud."[3]

The Court should seize this opportunity to provide needed guidance to the lower courts. Due to the heavy emphasis on settlement in individual bankruptcy cases, many cases raising the question presented are resolved before they reach the courts of appeals. Unless this Court grants review now, the lower courts will continue to apply Section 523(a)(2)(A) in an inconsistent manner. And some courts will continue to aid and encourage dishonest debtors by using the Bankruptcy Code to discharge debts for money obtained through deliberate fraudulent-transfer schemes. This Court's immediate intervention is warranted.

III. THE DECISION BELOW IS WRONG

This Court should also grant certiorari because the decision below is wrong for several reasons.

(continued...)

Dec. 16, 2011); *In re Perry*, 448 B.R. 219, 225 (Bankr. N.D. Ohio 2011); *In re Hendry*, 428 B.R. 68, 81 (Bankr. D. Del. 2010); *In re Kiesewetter*, 391 B.R. 740, 748 (Bankr. W.D. Penn. 2008); *In re Draughon*, 2007 WL 7645346, at *6 (Bankr. W.D. Pa. Aug. 21, 2007); *In re Barber*, 281 B.R. 617, 624 (Bankr. W.D. Pa. 2002).

[3] *See, e.g., In re Sharma*, 2015 WL 3825887, at *5 (Bankr. N.D. Cal. 2015); *In re Lewis*, 2010 WL 1379770, at *3 (Bankr. E.D. Tex. 2010); *In re Woodford*, 403 B.R. 177, 188 (Bankr. D. Mass. 2009); *In re Hathaway*, 364 B.R. 220, 232 & n.17 (Bankr. E.D. Va. 2007); *In re McKnew*, 270 B.R. 593, 618 & n. 40 (Bankr. E.D. Va. 2001).

1. "It is well established that [w]here Congress uses terms that have accumulated settled meaning under . the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms." *Community for Creative Non–Violence v. Reid*, 490 U.S. 730, 739 (1989) (internal quotation marks and citation omitted). And since at least the early 20th century, the common law of fraudulent conveyances has used the term "actual fraud" to refer to *actual* fraudulent transfers, which are intended to hinder or delay creditors (as distinguished from mere *constructive* fraudulent transfers, which require no such ill intent). Thus, when Congress added "actual fraud" to Section 523(a)(2)(A) in 1978, that term clearly encompassed the type of fraudulent-transfer scheme at issue here.

Section 7 of the Uniform Fraudulent Conveyance Act of 1918 was entitled "Conveyance Made With Intent to Defraud," and it stated that "[e]very conveyance made and every obligation incurred with *actual intent*, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors." 7A pt. 2 U.L.A. 378 (2006) (emphasis added). Based on this understanding, courts before 1978 commonly used the term "actual fraud" to refer to fraudulent-transfer schemes that were *actually intended* to hinder or delay creditors, regardless of whether there was any misrepresentation. *See id.* at 406-07 Notes 37–38 (discussing "actual fraud"). As one court put it:

> An existing creditor seeking to set aside a conveyance may do so either because of

> actual fraud or on account of what is termed constructive fraud. *Actual fraud* denotes the actual mental operation of intending to defeat or delay the rights of the creditor. Constructive fraud, on the other hand, is based on facts and circumstances which the courts have said constitute legal fraud irrespective of actual intent.

Smith v. Wilder, 120 So. 2d 871, 882 (Ala. 1960) (emphasis added).

Accordingly, it has long been recognized that "[p]roof of intent to hinder or delay creditors is proof of actual fraud" by a debtor. *Hofmann v. La Fontaine*, 16 F. Supp. 748, 752 (D. Wyo. 1936) (citing *Lovett v. Faircloth*, 10 F.2d 301, 304 (5th Cir. 1925)). The Fifth Circuit itself recognized the point in 1969. *See Ala. Credit Corp. v. Deas*, 417 F.2d 135, 139 (5th Cir. 1969) ("Actual fraud means actual intent to defeat or delay the rights of creditors. Constructive fraud is based upon facts and circumstances which the courts hold as constituting legal fraud irrespective of actual intent."). And this understanding of "actual fraud" has endured to the present day. In New York, for example, it is black-letter law that "[t]o secure summary judgment on a theory of 'actual fraud'" a bankruptcy trustee may prevail by showing that "(1) [the debtor] transferred the property with 'actual intent to hinder, delay or defraud his creditors,'" and (2) [the transferee] had "knowledge of the fraud at the time of the purchase." *In re Corcoran*, 246 B.R. 152, 161 (E.D.N.Y. 2000) (citing N.Y. Debt. & Cred. Law §§ 276, 278(1)). This type of "actual fraud" does not require any misrepresentation. *See generally*

Uniform Fraudulent Transfer Act of 1984, § 4, Note 18, *reprinted in* 7A pt. 2 U.L.A. 75 (2006) (noting that fraudulent transfers may involve "Actual or constructive fraud").

There can be no doubt that Congress understood this long-established common-law meaning of "actual fraud" when it added the term to Section 523(a)(2)(A) of the Bankruptcy Code in 1978. Indeed, "[a]s the leading treatise on bankruptcy explains, '[a]ctual fraud, by definition, consists of *any* deceit, artifice, trick, or design involving direct and active operation of the mind, used to circumvent and cheat another.'" *Lawson*, 2015 WL 3982395, at *3 (emphasis added) (quoting 4 COLLIER ON BANKRUPTCY ¶ 523.08[1][e] (A.N. Resnick & H.J. Sommer, eds., 16th ed. 2015)). The phrase "actual fraud" in Section 523(a)(2)(A) should be construed in accordance with that common-law understanding.

2. In reaching a contrary conclusion, the Fifth Circuit relied heavily on this Court's decision in *Field*, 516 U.S. 59, which addressed the level of reliance necessary to trigger the "actual fraud" bar to discharge in a case of alleged fraudulent misrepresentation. Pet. App. 9a-12a. But, as the Seventh Circuit pointed out, "*Field* has nothing to do with" whether there can be "actual fraud" without a misrepresentation, because "[t]he fraud there took the form of a misrepresentation, and the only issue was the nature of the reliance that a plaintiff must show to prove fraud *in such a case*." *McClellan*, 217 F.3d at 892 (emphasis added). "Nothing in [*Field*] suggests that misrepresentation is the only type of fraud that can give rise to a debt that is not dischargeable under section 523(a)(2)(A)," because

"[n]o other type of fraud was alleged in the case or discussed in the opinion." *Id.*

In fact, *Field*'s methodology establishes that "actual fraud" *does* include deliberate fraudulent-transfer schemes. *Field* explained that "actual fraud" should be understood by reference to the common law in 1978, when that phrase was added to the Bankruptcy Code. *See* 516 U.S. at 69. As explained above, and as both the First and Seventh Circuits recognized, the common-law understanding of "actual fraud" in 1978 easily encompassed deliberate fraudulent-transfer schemes. *See Lawson* 2015 WL 3982395, at *3-4; *McClellan*, 217 F.3d at 893.

3. The Fifth Circuit's interpretation of "actual fraud" to mean false representation creates needless surplusage because Section 523(a)(2)(A) refers separately to both "false representation" and "actual fraud" in sequence. As the Seventh Circuit explained, "by distinguishing between 'a false representation' and 'actual fraud,' the statute makes clear that actual fraud is broader than misrepresentation." *McClellan.* 217 F.3d at 893; *see also Lawson*, 2015 WL 3982395 at *4. The Fifth Circuit noted that the canon against surplusage is not absolute, and speculated that "actual fraud" may have been added to the statute "only to codify 'the limited scope of the fraud exception' as expressed in case law 'interpret[ing] "fraud" to mean actual or positive fraud rather than fraud implied by law.'" Pet. App. 15a (citation omitted). But that is a bizarre explanation: the statute *already* referred specifically to "false representation[s]" before 1978, so adding "actual fraud" could not have served to "limit[]" the

scope of Section 523(a)(2)(A) to fraudulent misrepresentations.

4. The Fifth Circuit reasoned that Section 523(a)(2)(A) must not address actual fraudulent transfers because the Bankruptcy Code contains a separate provision that specifically "excepts from discharge certain fraudulent transfers." Pet. App. 16a (citing 11 U.S.C. § 727(a)(2)(A)). But Section 727 and Section 523 serve very different purposes: While Section 727 blocks the debtor's ability to obtain a discharge *of any debts whatsoever*, Section 523 is targeted more narrowly at the discharge of *particular* debts. Thus, a debtor who violates Section 727 becomes ineligible for *any* discharge, while a debtor who violates Section 523 becomes ineligible to discharge only those debts that have been specifically tainted by fraud. "The concept of nondischargeability of a particular debt under section 523 is not to be confused with denial of discharge for all debts under section 727. It is extremely common for a debtor with nondischargeable debts to receive a discharge." 6 COLLIER ON BANKRUPTCY ¶ 727.01.

Moreover, Section 727(a)(2) applies only where the debtor diminishes the bankruptcy estate by *transferring property away*. *See* 11 U.S.C. § 727(a)(2) (denying a discharge where "the debtor, with intent to hinder, delay, or defraud a creditor . has *transferred, removed, destroyed, mutilated, or concealed* property of the debtor or property of the estate") (emphasis added)). Thus, Section 727(a)(2) would not apply in a case like *McClellan*, where the debtor only *received* a fraudulent transfer. Nor would Section 727 apply in a case like *Lawson*, which arose under Chapter 13,

because "[t]he applicability of section 727 is confined to chapter 7 cases." 6 COLLIER ¶ 727.01. Section 523 therefore serves an independent purpose because it applies in Chapter 13 where Section 727 does not. *See* 11 U.S.C. §§ 723(b), 1328(a)(2).

5. The Fifth Circuit also wrongly concluded that two "other exceptions to discharge in the Bankruptcy Code may be rendered redundant" by Husky's reading of "actual fraud." Pet. App. 16a (citing 11 U.S.C. §§ 523(a)(4), (a)(6)). Both of the cited provisions have a different scope than the "actual fraud" prong of Section 523(a)(2)(A).

Section 523(a)(4) bars the discharge of a debt resulting from a debtor's "defalcation while acting in a fiduciary capacity." But defalcation reaches a broader range of fiduciary misconduct than "actual fraud." The majority of circuits have held that defalcation requires only recklessness, while three circuits have held that even "an innocent mistake can constitute a defalcation" under Section 523(a)(4). *See In re Hyman*, 502 F.3d 61, 67 (2d Cir. 2007) (citing cases). Either way, defalcation does not require a fiduciary to have actual fraudulent intent, and thus Section 523(a)(4) captures certain reckless or negligent fiduciary conduct that is not covered by the "actual fraud" prong of Section 523(a)(2)(A).

Section 523(a)(6) bars the discharge of debts incurred as the result of "willful and malicious injury by the debtor to another entity or to the property of another entity." This provision extends to "intentional torts" that do not involve any type of "fraud" at all, such as assaulting someone or setting his car on fire. *See Kawaauhau v. Geiger*, 523 U.S.

57, 61-62 (1998). Moreover, unlike Section 523(a)(2)(A), which applies in *all* Chapter 13 cases, Section 523(a)(6) does not apply in most Chapter 13 cases. *See* 11 U.S.C. § 1328(a)(2); *Lawson*, 2015 WL 3982395 at *6 & n.13. Thus, under the Fifth Circuit's interpretation, "especially clever" debtors would be able to defraud their victims through deliberate fraudulent-transfer schemes, and then avoid any discharge bar by filing for bankruptcy under Chapter 13 instead of Chapter 7 *Id.* at *7. Congress could not possibly have intended that result.

6. Finally, applying Section 523(a)(2)(A) to deliberate fraudulent-transfer schemes serves the statutory purpose of barring discharge in cases of intentional wrongdoing. When a debtor like Ritz orchestrates a deliberate scheme to cheat a creditor, the bar to discharge should apply regardless of "whether the intent to defraud was implemented by a misrepresentation or by some other improper means." *McClellan*, 217 F.3d at 894. Indeed, as this Court has recognized, "it is unlikely that Congress would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud." *Cohen v. de la Cruz*, 523 U.S. 213, 223 (1998) (internal quotation marks and citation omitted).

CONCLUSION

For all of these reasons, the petition for certiorari should be granted and the decision below reversed.

Respectfully submitted,

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July 2015

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT.

IN THE MATTER OF DANIEL LEE RITZ, JR., ALSO KNOWN AS BO RITZ, DEBTOR.
HUSKY INTERNATIONAL ELECTRONICS, INCORPORATED, APPELLANT
V
DANIEL LEE RITZ, JR., APPELLEE.

NO. 14-20526. MAY 22, 2015.

Appeal from the United States District Court for the Southern District of Texas.

Before STEWART, Chief Judge, and KING and ELROD, Circuit Judges.

Opinion

KING, Circuit Judge.

Appellant Husky International Electronics, Inc. brought this adversary proceeding against Appellee and debtor Daniel Lee Ritz, Jr., objecting to the discharge of a $163,999.38 contractual debt owed to Husky by Chrysalis Manufacturing Corp.—of which Ritz was a shareholder. Husky sought to except the debt from discharge under either 11 U.S.C. § 523(a)(2)(A) or 11 U.S.C. § 523(a)(6). The bankruptcy court denied all relief sought by Husky, determining that the debt was dischargeable. The

district court affirmed on appeal. For the following reasons, we AFFIRM.

I. Factual and Procedural Background

The facts underlying this adversary proceeding are straightforward. Appellant Husky International Electronics, Inc. ("Husky"), is a Colorado-based seller of electronic device components. From 2003 to 2007, Husky sold and delivered goods to Chrysalis Manufacturing Corp. ("Chrysalis") pursuant to a written contract. It is undisputed that Chrysalis failed to pay for all of the goods it purchased from Husky, and that Chrysalis owed a debt to Husky in the amount of $163,999.38. At all relevant times, Appellee Daniel Lee Ritz, Jr., the debtor, was in financial control of Chrysalis. Moreover, Ritz was a director of Chrysalis and owned at least 30% of Chrysalis's common stock.

Between November 2006 and May 2007, Ritz transferred a substantial amount of Chrysalis's funds to various entities controlled by Ritz. Specifically, Ritz transferred: (1) $677,622 to ComCon Manufacturing Services, Inc.; (2) $121,831 to CapNet Securities Corp. (of which Ritz held an 85% ownership interest); (3) $52,600 to CapNet Risk Management, Inc. (of which Ritz held a 100% ownership interest); (4) $172,100 to Institutional Capital Management, Inc., and Institutional Insurance Management, Inc. (of which Ritz held 40% and 100% ownership interests, respectively); (5) $99,386.90 to Dynalyst Manufacturing Corp. (of which Ritz held a 25% ownership interest); (6) $26,500 to Clean Fuel International Corp. (of which Ritz held a 20% ownership interest); and (7) $11,240 to CapNet Advisors, Inc. With respect to each of these

transfers, the bankruptcy court concluded that Chrysalis did not receive reasonably equivalent value in exchange. [1] The bankruptcy court further determined that during this time, Chrysalis was operational, but was not paying its debts as they became due. The bankruptcy court found that at all relevant times, the sum of Chrysalis's debts was greater than that of Chrysalis's assets at a fair valuation.

In May 2009, Husky sued Ritz in federal district court, seeking to hold Ritz personally liable for Chrysalis's $163,999.38 debt. In December 2009, Ritz filed a voluntary Chapter 7 petition for bankruptcy in the United States Bankruptcy Court for the Southern District of Texas. In March 2010, Husky filed a complaint in the bankruptcy court initiating the adversary proceeding underlying this appeal. In the complaint, Husky objected to the discharge of Ritz's alleged debt, relying on 11 U.S.C. §§ 523(a)(2)(A), 523(a)(4), and 523(a)(6).[2]

The bankruptcy court held a trial in February 2011. The court issued its Memorandum Opinion, including findings of fact and conclusions of law, in August

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[1] Ritz does not dispute that these transfers were made, but he challenges the bankruptcy court's conclusion regarding reasonably equivalent value—contending that these entities transferred more money into Chrysalis then was transferred out. We need not determine whether the bankruptcy court's findings as to this issue were clearly erroneous. Whether or not Chrysalis received reasonably equivalent value for the transfers, we conclude, for the reasons discussed below, that the exceptions to discharge raised by Husky are inapplicable.

[2] The bankruptcy court determined that Husky could not prevail under Section 523(a)(4), a determination Husky does not challenge on appeal.

2011. As noted above, the court found that the transfers Ritz orchestrated were not made for reasonably equivalent value. The court also found that Husky suffered damages due to these transfers—specifically, "in the amount of $163,999.38—which represents the amount owed to Husky by Chrysalis for the goods which Husky delivered to Chrysalis." In addition, the court determined that Ritz was "not a credible witness" due to his contradictory and evasive testimony, and due to his "selective" inability to recall certain information. In its conclusions of law, the bankruptcy court first addressed whether Ritz could be held liable for Chrysalis's debt under Texas veil-piercing laws. The court determined that, under Texas law, Husky had not established that Ritz perpetuated an "actual fraud" on Husky—a prerequisite for piercing the veil under Texas Business Organizations Code Section 21.223(b)—because Husky failed to show that Ritz made a false representation to Husky. The bankruptcy court found that the record was "wholly devoid of any such representation made by [Ritz]." For this same reason, the court determined that the "actual fraud" exception to discharge contained in 11 U.S.C. § 523(a)(2)(A) did not apply. Finally, the bankruptcy court rejected the applicability of the "willful and malicious injury" exception to discharge under 11 U.S.C. § 523(a)(6), concluding that Husky failed to sufficiently brief and adduce evidence on this provision, and stating that "[t]he record is wholly devoid of any proof that [Ritz] willfully and maliciously injured Husky or Husky's property." Accordingly, the bankruptcy court denied all of Husky's requested relief.

On appeal, the district court relied on a Fifth Circuit case issued after the bankruptcy court's decision, *Spring Street Partners–IV, L.P. v. Lam*, 730 F.3d 427 (5th Cir. 2013), in determining that Husky could pierce the corporate veil because there was sufficient circumstantial evidence suggesting that Ritz acted with the intent to hinder, delay, or defraud Husky. Nonetheless, the court held that Husky had not established actual fraud under 11 U.S.C. § 523(a)(2)(A), which requires a misrepresentation. Finally, the district court rejected the applicability of 11 U.S.C. § 523(a)(6), as Husky "fail[ed] to show by a preponderance of the evidence that Ritz acted willfully and maliciously." Accordingly, the district court affirmed. Husky timely appealed.

II. Standard of Review

"When a court of appeals reviews the decision of a district court, sitting as an appellate court, it applies the same standards of review to the bankruptcy court's findings of fact and conclusions of law as applied by the district court." *Jacobsen v. Moser (In re Jacobsen)*, 609 F.3d 647, 652 (5th Cir. 2010) (internal quotation marks omitted). Accordingly, we review conclusions of law de novo and findings of fact for clear error. *Bank of La. v. Bercier (In re Bercier)*, 934 F.2d 689, 691 (5th Cir. 1991). "[W]e will affirm the bankruptcy court's findings unless on the entire evidence, this court is left with the definite and firm conviction that a mistake has been committed." *Id.* (internal quotation marks and brackets omitted). Moreover, where, as here, "the district court has affirmed the bankruptcy court's findings, the clear error standard is strictly applied." *Frazin v. Haynes & Boone, L.L.P. (In re Frazin)*, 732 F.3d 313, 317 (5th

Cir. 2013) (internal quotation marks and brackets omitted).

III. Discussion

On appeal, Husky contends as a threshold matter that Ritz committed "actual fraud" under Texas Business Organizations Code Section 21.223(b) and thus can be held liable for Chrysalis's debt. Husky further argues that the debt is excepted from discharge in bankruptcy under either the "actual fraud" clause in 11 U.S.C. § 523(a)(2)(A), or as debt due to "willful and malicious injury" under 11 U.S.C. § 523(a)(6). Because we conclude—as did the bankruptcy and district courts—that neither of these exceptions to discharge applies, we need not reach the first issue.

A. "Actual Fraud" Under 11 U.S.C. § 523(a)(2)(A)

"The Bankruptcy Code has long prohibited debtors from discharging liabilities incurred on account of their fraud, embodying a basic policy animating the Code of affording relief only to an honest but unfortunate debtor." *Cohen v. de la Cruz*, 523 U.S. 213, 217 (1998) (internal quotation marks omitted). In accordance with that policy, Section 523(a)(2)(A) excepts from discharge "any debt ... for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by ... false pretenses, a false representation, or actual fraud." Husky asserts that the debt at issue is one for money obtained by "actual fraud." The parties vigorously dispute the meaning of this term—particularly, whether "actual fraud" can be established where, as here, the debtor made no false

representation to the creditor.[3] Guided by Supreme Court and Fifth Circuit precedent, we conclude that it cannot.[4]

Husky's argument that a false representation is unnecessary to trigger the "actual fraud" clause of Section 523(a)(2)(A) rests almost exclusively on *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000). In *McClellan*, a divided panel of the Seventh Circuit held that "actual fraud" under that provision "is not limited to misrepresentations and misleading omissions." 217 F.3d at 893. The court faced a situation in which the creditor sold machinery to the debtor's brother for $200,000, payable in installments. *Id.* at 892. The brother defaulted, owing the creditor more than $100,000. *Id.* The creditor sued the brother and, with the suit pending, the brother sold the machinery to his sister, the debtor, for $10; she later resold the machinery for $160,000. *Id.* The debtor was aware of the lawsuit and "was colluding with her brother to thwart [the creditor]'s collection of the debt that her brother owed him." *Id.* The debtor ultimately filed for bankruptcy, and the creditor brought an adversary proceeding to recover the debt. *Id.* At issue in *McClellan* was whether that debt was barred from discharge under the "actual fraud" clause of Section 523(a)(2)(A)—despite the fact

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[3] Husky concedes that "Ritz made no oral or written representations to Husky inducing Husky to enter into a contract with Chrysalis." Nor does Husky point to any other false representations made by Ritz to Husky.

[4] Accordingly, we need not reach Ritz's alternative arguments that: (1) the debt at issue was not "obtained by" fraud, 11 U.S.C. § 523(a)(2)(A), and (2) Ritz did not make the transfers with the intent to deceive Husky.

that the debtor made no false representation to the creditor. Judge Posner, writing for the majority, distinguished the "[p]lenty of cases [that] ... assume that fraud equals misrepresentation," as those were "cases in which the only fraud charged was misrepresentation." *Id.* The court concluded that a fraudulent misrepresentation "is not the only form that fraud can take or the only form that makes a debt nondischargeable," *id.* at 894, relying in part on the fact that the provision covers both "false representation[s]" and "actual fraud": "[B]y distinguishing between 'a false representation' and 'actual fraud,' the statute makes clear that actual fraud is broader than misrepresentation," *id.* at 893. Accordingly, the court concluded that actually fraudulent conveyances—i.e., conveyances through which the debtor *intends* to hinder the creditor—constitute "actual fraud" under Section 523(a)(2)(A).[5] *Id.* at 894–95. The court further reasoned that the debt at issue "arose not when [the debtor's] brother borrowed money from [the creditor] but when [the debtor] prevented [the creditor] from collecting from the brother the money the brother owed him." *Id.* at 895. Accordingly, the debt was for "property ... obtained by fraud." *Id.* In a concurrence, Judge Ripple noted that the majority's interpretation was "perhaps strained," and therefore concluded that a different exception to discharge—Section 523(a)(6)—"provides a far more direct avenue for dealing with a situation such as the one" before the court. *Id.* at 896 (Ripple, J., concurring).

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[5] The court reasoned that constructively fraudulent transfers—those for which no reasonably equivalent value is received—would not constitute "actual fraud." *Id.* at 894–95.

No subsequent appellate court has adopted the interpretation of Section 523(a)(2)(A) endorsed by the *McClellan* majority,[6] and we decline to do so today. First, *McClellan* appears to be in tension with the Supreme Court's opinion in *Field v. Mans*, 516 U.S. 59 (1995), which "resolve[d] a conflict among the Circuits over the level of reliance that § 523(a)(2)(A) requires a creditor to demonstrate." *Id.* at 63. The Court reasoned that the terms " 'false pretenses, a false representation, or actual fraud,' carry the acquired meaning of terms of art" and "imply elements that the common law has defined them to include." *Id.* at 69. Because the district court treated the conduct at issue "as amounting to fraud," the Court "look[ed] to the concept of 'actual fraud' as it was understood in 1978 when the language was added to § 523(a)(2)(A)."[7] *Id.* at 70. The Court relied

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[6] Husky mistakenly asserts that both the Sixth and Tenth Circuits have followed *McClellan*. Although *bankruptcy appellate panels* in those circuits have adopted *McClellan's* reasoning, see *Mellon Bank, N.A. v. Vitanovich (In re Vitanovich)*, 259 B.R. 873, 877 (6th Cir. BAP 2001); *Diamond v. Vickery (In re Vickery)*, 488 B.R. 680, 691 (10th Cir. BAP 2013), no circuit court has done so, *cf. McCrory v. Spigel (In re Spigel)*, 260 F.3d 27, 32 n. 7 (1st Cir. 2001) ("[W]e do not decide whether we would adopt the Seventh Circuit's reasoning [in *McClellan*].") Other bankruptcy courts have explicitly rejected the *McClellan* approach. *See, e.g., Sauer Inc. v. Lawson (In re Lawson)*, 505 B.R. 117, 123 (Bankr. D.R.I. 2014); *Blacksmith Invs. v. Woodford (In re Woodford)*, 403 B.R. 177, 188 (Bankr. D.Mass. 2009); *McKnew v. KMK Factoring, L.L.C. (In re McKnew)*, 270 B.R. 593, 618 n. 40 (Bankr. E.D. Va.2001).

[7] Prior to 1978, an earlier version of the provision "provided that debts that were 'liabilities for obtaining property by false pretenses or false representations' would not be affected by any discharge granted to a bankrupt." *Id.* at 64.

primarily on the Restatement (Second) of Torts, published shortly before Congress passed the current version of Section 523(a)(2)(A). *Id.* The Court focused on "[t]he section on point dealing with fraudulent misrepresentation," which stated that "both actual and 'justifiable' reliance are required." *Id.* The Court also noted that the edition of Prosser's Law of Torts available in 1978 "states that justifiable reliance is the standard." *Id.* at 71. Accordingly, the Court concluded that the applicable standard is "one of justifiable reliance." *Id.* at 61.

Although not directly addressing the issue, the Court throughout its opinion in *Field* appeared to assume that a false representation is necessary to establish "actual fraud." *See, e.g., id.* at 68 ("If Congress really had wished to bar discharge to a debtor who made unintentional and wholly immaterial misrepresentations having no effect on a creditor's decision, it could have provided that."); *see also id.* at 79 (Breyer, J., dissenting) ("I agree with the Court's holding that 'actual fraud' under 11 U.S.C. § 523(a)(2)(A) incorporates the common-law elements of intentional misrepresentation.").[8] The majority in

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[8] Indeed, in a separate concurrence, Justice Ginsburg strongly suggested that the debt at issue would not have been dischargeable absent a representation:

> At oral argument, the following exchange between the Court and the Fields' attorney occurred:
>
> "QUESTION: ... Suppose the debtor here had simply transferred th[e] property without saying one word to the creditor.... [W]ould [the debt] then be dischargeable? There would be no representation at all, just in violation of the agreement the debtor sells the property.... Dischargeable, right?

McClellan asserted that *Field* was inapposite because "[t]he fraud there took the form of a misrepresentation" and "[n]othing in the Supreme Court's opinion suggests that misrepresentation is the only type of fraud that can give rise to a debt that is not dischargeable under section 523(a)(2)(A)." *McClellan*, 217 F.3d at 892. Although it is true that the facts underlying *Field* involved a misrepresentation, we do not believe that the case can be so easily disregarded. Nowhere in *Field* did the Court suggest that different definitions of "actual fraud" apply depending on "the type of fraud ... alleged." *Id.* Rather, the Court looked to the Restatement (Second) of Torts and Prosser's Law of Torts in analyzing "*the* concept of 'actual fraud' as it was understood in 1978." *Field*, 516 U.S. at 70 (emphasis added). Both of those sources indicate that a representation is a necessary prerequisite. *See* Restatement (Second) of Torts § 537 (1977) ("The recipient of a fraudulent misrepresentation can recover against its maker for pecuniary loss resulting from it if, but only if ... he relies on the misrepresentation in acting or refraining from

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"MR. SEUFERT: While [those are] not the facts of this case, I would agree with you, it would be dischargeable." [Tr. Of Oral Arg.] at 8–9.

It bears consideration whether a debt that would have been dischargeable had the debtor simply transferred the property, in violation of the due-on-sale clause with never a word to the creditor, nonetheless should survive bankruptcy because the debtor wrote to the creditor of the prospect, albeit not the actuality, of the transfer.

Id. at 79 (Ginsburg, J., concurring) (alterations in original).

action....");[9] William J. Prosser, Law of Torts § 106, p. 694 (4th ed. 1971) ("The representation which will serve as a basis for an action of deceit, as well as other forms of relief, usually consists, of course, of oral or written words; but it is not necessarily so limited." (footnote omitted)). Moreover, at bottom, the Court in *Field* made clear that the meaning of "actual fraud" depends on the 1978 common law meaning of the term. *Field*, 516 U.S. at 70. Husky has pointed to no authority, and we are not aware of any, suggesting that the common law meaning of "actual fraud" at that time encompassed fraudulent transfers of the type at issue here. Indeed, Husky's counsel conceded at oral argument that fraudulent transfers are statutory constructs, and are "not ... creature[s] of the common law."

Moreover, the reasoning in *McClellan* is at best inconsistent with, if not foreclosed by, our own Fifth

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[9] Although some may quarrel with the *Field* Court's focus on the "fraudulent misrepresentation" provision of the Restatement in interpreting the term "actual fraud," such an argument is a challenge to *Field* itself—a decision to which we are bound. In any event, Husky has not pointed to any other provision of the Restatement that it contends is applicable to the conduct at issue here. Another provision does state that one may be liable to another for *nondisclosure* where "he is under a duty of care to the other to exercise reasonable care to disclose the matter in question,"—e.g., where the parties have "a fiduciary or other similar relation of trust and confidence between them." Restatement (Second) of Torts § 551. However, such fraud is addressed in a separate provision of Section 523—11 U.S.C. § 523(a)(4)—which excepts debts "for fraud or defalcation while acting in a fiduciary capacity." In rejecting the applicability of that provision, the bankruptcy court determined that "[Ritz] owed no fiduciary duty to [Husky]"—a determination Husky has not challenged on appeal.

Circuit precedent. In cases both prior and subsequent to *Field* and *McClellan*, we have stated in no uncertain terms:

> In order to prove nondischargeability under an "actual fraud" theory, the objecting creditor *must prove* that: (1) *the debtor made representations*; (2) at the time they were made the debtor knew they were false; (3) the debtor made the representations with the intention and purpose to deceive the creditor; (4) that the creditor relied on such representations; and (5) that the creditor sustained losses as a proximate result of the representations.

RecoverEdge L.P. v. Pentecost, 44 F.3d 1284, 1293 (5th Cir. 1995) (emphasis added) (internal quotation marks and footnote omitted); *see Gen. Elec. Capital Corp. v. Acosta (In re Acosta)*, 406 F.3d 367, 372 (5th Cir. 2005) ("For a debt to be nondischargeable under section 523(a)(2)(A), the creditor must show (1) that the debtor made a representation...."). Although these cases did not directly address whether fraudulent transfers may constitute "actual fraud" under Section 523(a)(2)(A), we are at the very least hesitant to hold that a creditor need not fulfill one of the express requirements we have repeatedly delineated in our test for "actual fraud."[10]

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[10] We recognize that the Fifth Circuit, sitting en banc, noted that it was "*not* required to address" whether the elements of "actual fraud" listed in our prior cases "survived *Field*." *AT & T Universal Card Servs. v. Mercer (In re Mercer)*, 246 F.3d 391, 403 (5th Cir. 2001) (en banc). However, for the reasons discussed above, *Field* is entirely consistent with—and may even compel—the conclusion that a representation is a necessary prerequisite to a finding of "actual fraud." Furthermore, were a representation unnecessary, one of the

But even setting aside *Field* and our precedent, there are other reasons we choose not to follow *McClellan*. *McClellan* and its progeny rely heavily on the theory that because Section 523(a)(2)(A) includes the phrase "false representation," reading "actual fraud" to require such a representation renders the latter phrase redundant. *See McClellan*, 217 F.3d at 893; *see also In re Vickery*, 488 B.R. at 691. Although as a general rule we aim to "give effect, if possible, to every word Congress used" in construing statutes, *Pilgrim's Pride Corp. v. Comm'r of Internal Revenue*, 779 F.3d 311, 316 (5th Cir. 2015) (internal quotation marks omitted), that canon of construction is not a rigid, inviolable dictate. Such canons "are tools designed to help courts better determine what Congress intended, not to lead courts to interpret the law contrary to that intent." *Scheidler v. Nat'l Org. for Women, Inc.*, 547 U.S. 9, 23 (2006); *see also Chickasaw Nation v. United States*, 534 U.S. 84, 94 (2001) ("[T]hese canons do not determine how to read this statute. For one thing, canons are not mandatory rules. They are guides that need not be conclusive. They are designed to help judges determine the Legislature's intent as embodied in particular statutory language. And other circumstances evidencing congressional intent can overcome their force." (internal citation and quotation marks omitted)); Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 176

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main issues in *In re Mercer*—whether the use of a credit card constituted a "representation of intent to pay," *id.* at 404–07—would have been rendered irrelevant, *see id.* at 426 (Duhé, J., dissenting) ("If one can 'infer' a representation from use of the card, then the creditor is relieved of the obligation of proving that a false representation was made.").

(2012) ("[The canon against surplusage] cannot always be dispositive because (as with most canons) the underlying proposition is not *invariably* true."). Here, although "actual fraud" was added to the statute in 1978, some have suggested that Congress did not intend to create a separate basis for dischargeability—but rather intended only to codify "the limited scope of the fraud exception" as expressed in case law "interpret[ing] 'fraud' to mean actual or positive fraud rather than fraud implied by law." *RecoverEdge*, 44 F.3d at 1292 n. 16 (internal quotation marks omitted); Alan N. Resnick & Henry J. Sommer, Collier on Bankruptcy ¶ 523.08[01][e] (16th ed. 2014) ("Section 523(a)(2)(A) was intended to codify case law ... which interpreted 'fraud' to mean actual or positive fraud rather than fraud implied by law."); *Cohen*, 523 U.S. at 221 (stating that pre- and post-1978 versions of Section 523(a)(2)(A) are "substantially similar").[11]

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[11] Even assuming Congress intended the phrase "actual fraud" to have a meaning independent from the other phrases in that provision, this court has noted a theory under which "actual fraud" would not be redundant of those other phrases. *See In re Bercier*, 934 F.2d at 692 (reasoning that "false representations and false pretenses ... encompass statements that falsely purport to depict *current or past facts*" while "actual fraud" concerns "promises of future action which, *at the time they were made*, [the debtor] had no intention of fulfilling"). Notably, this distinction would survive even given our conclusion that "actual fraud" requires a misrepresentation. However, we need not, and do not, expressly adopt any of these theories for Congress's inclusion of "actual fraud" in Section 523(a)(2)(A). We note these theories only to suggest that, contrary to the *McClellan* majority's contention, our reading of "actual fraud" is unlikely to render the phrase meaningless or redundant.

We also note that another provision of the Bankruptcy Code, Section 727(a)(2), excepts from discharge certain fraudulent transfers. 11 U.S.C. § 727(a)(2)(A) ("The court shall grant the debtor a discharge, unless ... the debtor, with intent to hinder, delay, or defraud a creditor ... has transferred ... property of the debtor...."). It would appear odd, at the very least, for Congress to have intended that the "actual fraud" provision cover fraudulent transfers, when there is another provision directly addressing such transfers. *See United States v. $92,203.00 in U.S. Currency*, 537 F.3d 504, 509–10 (5th Cir. 2008) ("We are to read a statute as a whole, so as to give effect to each of its provisions without rendering any language superfluous." (internal citation marks omitted)). Husky did not raise this fraudulent transfer provision below. Moreover, other exceptions to discharge in the Bankruptcy Code may be rendered redundant by the *McClellan* majority's broad, omnibus construction of "actual fraud." *See* 11 U.S.C. § 523(a)(4) (excepting debts "for fraud or defalcation while acting in a fiduciary capacity"); *id.* § 523(a)(6) (excepting debts "for willful and malicious injury by the debtor to another entity or to the property of another entity").

Finally, to the extent Section 523(a)(2)(A) is ambiguous, "[e]xceptions to discharge should be construed in favor of debtors in accordance with the principle that provisions dealing with this subject are remedial in nature and are designed to give a fresh start to debtors unhampered by pre-existing financial burdens." *Fezler v. Davis (In re Davis)*, 194 F.3d 570, 573 (5th Cir. 1999); *see also Hickman v. Texas (In re Hickman)*, 260 F.3d 400, 404 (5th Cir. 2001)

("[E]xceptions to discharge are to be construed narrowly.").

For all of these reasons, we conclude that a representation is a necessary prerequisite for a showing of "actual fraud" under Section 523(a)(2)(A). Because the parties agree that the record contains no evidence of such a representation, discharge of the debt at issue is not barred under this provision.

B. "Willful and Malicious Injury" Under 11 U.S.C. § 523(a)(6)

Husky also challenges the bankruptcy court's conclusion that Section 523(a)(6) does not bar discharge of Ritz's alleged debt. Under that provision, a debt "for willful and malicious injury by the debtor to another entity or to the property of another entity" is excepted from discharge. 11 U.S.C. § 523(a)(6). The Supreme Court has interpreted this provision to require "a deliberate or intentional *injury*, not merely a deliberate or intentional act that leads to injury." *Kawaauhau v. Geiger*, 523 U.S. 57, 61 (1998). In *Kawaauhau*, the Court held that "debts arising from recklessly or negligently inflicted injuries do not fall within the compass of § 523(a)(6)." *Id.* at 64. Following *Kawaauhau*, this court has held "that an injury is 'willful and malicious' where there is either an objective substantial certainty of harm or a subjective motive to cause harm." *Miller v. J.D. Abrams, Inc. (In re Miller)*, 156 F.3d 598, 606 (5th Cir. 1998); *cf. McClendon v. Springfield (In re McClendon)*, 765 F.3d 501, 505 (5th Cir. 2014) ("[A]n individual who acts under an honest, but mistaken belief ... cannot be said to have intentionally caused injury, because absent the fact about which there has been a mistake, legally cognizable injury would not meet the

test of substantial certainty." (internal quotation marks omitted)).

In rejecting the applicability of Section 523(a)(6), the bankruptcy court stated that "[t]he record is wholly devoid of any proof that [Ritz] willfully and maliciously injured Husky or Husky's property." The court similarly concluded that Husky "failed to identify any tortious action by [Ritz] that caused a willful and malicious injury." (internal quotation marks omitted). Husky argues that these conclusions are at odds with the bankruptcy court's factual findings that Ritz "drained substantial funds out of Chrysalis[ ]" through transfers that were made without Chrysalis receiving reasonably equivalent value in return. But these findings are not incompatible with the court's rejection of Section 523(a)(6), as there appears to be scant evidence in the record indicating either that Ritz made these transfers with the intent to harm Husky, or that harm to Husky was substantially certain due to Ritz's actions. We note that it was Husky's burden to prove this exception to dischargeability by a preponderance of the evidence, *Grogan v. Garner*, 498 U.S. 279, 291 (1991), and as the bankruptcy court noted, "no exhibits were introduced" and "no testimony was adduced ... relating to § 523(a)(6)." *Cf. Williams v. Int'l Bhd. of Elec. Workers Local 520 (In re Williams)*, 337 F.3d 504, 511 (5th Cir. 2003) ("Although previous decisions by this circuit hold that injuries resulting from a knowing breach of contract may be nondischargeable under Section 523(a)(6), those decisions also require *explicit evidence* that a debtor's breach was intended or substantially certain to cause the injury to the creditor." (emphasis added)). Accordingly, the bankruptcy court did not err in

concluding that Section 523(a)(6) is inapplicable to the debt at issue.[12]

C. Equitable Considerations

Finally, Husky argues that, notwithstanding the provisions discussed above, we should direct the bankruptcy court to exercise its equitable powers to "prevent the U.S. Bankruptcy Code from becoming an engine of fraud." However, such equitable powers "must be exercised in a manner that is consistent with the Bankruptcy Code," and a bankruptcy court is not permitted "to create substantive rights that are otherwise unavailable under applicable law, or constitute a roving commission to do equity." *Perkins Coie v. Sadkin (In re Sadkin)*, 36 F.3d 473, 478 (5th Cir. 1994) (per curiam) (internal quotation marks omitted). For the reasons discussed above, the statutory exceptions to discharge raised by Husky are inapplicable, and Husky cannot rely upon general principles of equity to expand those exceptions. Indeed, as noted above, another provision of the Bankruptcy Code, Section 727(a)(2), may have applied to redress the conduct of which Husky complains—but Husky failed to raise that provision below.

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[12] We note that a portion of the bankruptcy court's analysis with respect to Section 523(a)(6) appeared to focus on Ritz's intent vis-à-vis the transaction between Husky and Chrysalis, as opposed to Ritz's intent at the time of the fraudulent transfers. In any event, the bankruptcy court's conclusions—that the record was "*wholly* devoid" of evidence that Ritz took "*any* ... action ... that caused a willful and malicious injury"—were not so limited. (emphasis added).

IV. Conclusion

For the foregoing reasons, we AFFIRM.

APPENDIX B

United States District Court
S.D. Texas
Houston Division

In re Daniel Lee RITZ, Jr., Debtor.
Husky International Electronics, Inc., Appellant
v.
Daniel Lee, Ritz, Jr., Appellee.

Civil Action No. H–11–3020. | Bankruptcy Case No. 09–39895–H4–7 | Adversary No. 10–03156. | Signed July 14, 2014.

OPINION AND ORDER

MELINDA HARMON, District Judge.

Pending before the Court is the above referenced appeal by Appellant Husky International Electronics, Inc. ("Husky"), seeking a reversal of United States Bankruptcy Judge Jeff Bohm's August 4, 2011 memorandum opinion and judgment[1] in Adversary Proceeding 10–03156, discharging a $163,999.38 contractual debt owed by Chrysalis Manufacturing Corp. ("Chrysalis") to Husky for goods Husky sold and delivered to Chrysalis from 2003 to 2007 under a

[1] Instrument # 9, Appendix A. Also available as *Husky International Electronics, Inc. v. Ritz (In re Ritz)*, 459 B.R. 623 (Bankr. S.D. Tex. 2011).

contract and for which Husky has attempted to hold Appellee/Debtor Daniel Lee Ritz, Jr. ("Ritz"), a director and shareholder of Chrysalis,[2] personally liable.[3] In this appeal Husky contends that the debt should be excepted from discharge in bankruptcy on the grounds of fraud pursuant, to 11 U.S.C. § 523(a)(2), and of willful or malicious injury to Husky or its property, pursuant to 11 U.S.C. § 523(a)(6).

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[2] Judge Bohm found, "At all relevant times, the Debtor was in financial control of Chrysalis. Moreover, he was the director and owner of at least 30% of Chrysalis common stock. [citations omitted]" *In re Ritz*, 459 B.R. at 627, ¶ 4.

[3] The opening lines of Judge Bohm's memorandum opinion summarize the dispute in the Adversary Proceeding:

> This adversary proceeding concerns an individual debtor [Daniel Lee Ritz, Jr.] who authorized transfers of funds out of one corporation [Chrysalis] into the accounts of several other companies—all of which he controlled. As a result of these transfers, the one corporation was drained of all its cash and, therefore, could not pay its creditors. One of these creditors [Husky] has filed suit against the debtor, alleging that: (a) because of the debtor's actions, [Ritz] has become personally liable for the debt owed by the corporation; and (b) this debt is nondischargeable under 11 U.S.C. §§ 523(a)(2)(A), (a)(4), & (a)(6). For the reasons set forth herein, this Court concludes that there is no debt to discharge because the plaintiff failed to establish any liability against the debtor.

Husky has not appealed the ruling under § 523(a)(4), but contests the others.

Husky does not challenge the bankruptcy judge's findings of fact or credibility determinations,[4] but only his conclusions of law. Husky raises three issues of legal error:

(1) Did the bankruptcy court err when it ignored that fraudulent transfers pursuant to Tex. Bus. &

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[4] This Court observes, "'[D]ue regard shall be given to the opportunity of the trial court to judge [ ] the credibility of witnesses.'" *Bertucci Contracting Corp. v. M/V ANTWERPEN*, 465 F.3d 254, 258 (5th Cir. 2006), *citing* Fed.R.Civ.P. 52(a) and *quoting Anderson v. City of Bessemer City, N.C.*, 470 U.S. 564, 573 (1985). "The court owes even greater deference to findings based on the credibility of witnesses and must uphold them if based on coherent, internally consistent, and facially plausible testimony that is not contradicted by external evidence." *Id.* at 259, *citing id.* at 575.

Of witnesses for Husky, Judge Bohm found the debtor, Ritz, was not a credible witness because at trial he made statements that contradicted answers that he had previously given in discovery on material issues and gave nonresponsive answers to unambiguous questions. Memorandum Op., #9, Appendix A at pp. 5–6 (examples given). He found that testimony of Nicholas C. Davis, president of Husky, very credible, as he did the testimony of several other witnesses: (1) Nancy K. Finney, comptroller for Ritz-controlled companies for approximately four years; (2) James D. Rogers, Vice President of Corporate Finance of CapNet Securities Corporation for approximately two and a half years; and (3) Richard Hollan, a shareholder of Institutional Capital Management, Inc., which was owned 40% by Ritz. *Id.* at pp. 7–8. Of Ritz's witnesses, he found Heather Cheaney to be credible, but that her testimony was not significant; he found Daniel Lee Ritz, Sr. to be credible, but gave little weight to his testimony, which was biased toward his son; he found Craig Takacs to be "a bit evasive" and gave little weight to his testimony; he found L. Andrew Well was not credible; and he found Marlin R. Williford to be "direct and forthcoming" and credible, but his testimony did not relate to the transfers of cash by Ritz out of Chrysalis and into the accounts of other entities controlled by Ritz. *Id.* at p. 8.

Com.Code § 24.005[5] are "actual fraud" within the meaning of Tex. Bus. Org.Code § 21.223(b)?[6]

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[5] The Texas Uniform Fraudulent Transfer Act ("TUFTA"), Texas Bus. & Com.Code § 24.005, "Transfers Fraudulent as to Present and Future Creditors," provides,

> (a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or within a reasonable time after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:
>
> (1) with actual intent to hinder, delay, or defraud any creditor of the debtor; or
>
> (2) without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:
>
> (A) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or
>
> (B) intended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor's ability to pay as they became due.
>
> (b) In determining actual intent under Subsection (a)(1) of this section, consideration may be given, among other factors, to whether:
>
> (1) the transfer or obligation was to an insider;
>
> (2) the debtor retained possession or control of the property transferred after the transfer;
>
> (3) the transfer or obligation was concealed;
>
> (4) before the transfer or obligation was incurred, the debtor had been sued or threatened with suit;
>
> (5) the transfer was of substantially all of the debtor's assets;

(6) the debtor absconded;

(7) the debtor removed or concealed the assets;

(8) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;

(9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;

(10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and

(11) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

[6] Section 21.223, "Limitation of Liability for Obligations," which applies only to Texas corporations and limited liability companies, recites,

(a) A holder of shares, an owner of any beneficial interest in shares, or a subscriber for shares whose subscription has been accepted, or any affiliate of such a holder, owner, or subscriber of the corporation, may not be held liable to the corporation or its obligees with respect to:

(1) the shares, other than the obligation to pay the corporation the full amount of consideration, fixed in compliance with Sections 21.157–21.162, for which the shares were or are to be issued;

(2) any contractual obligation of the corporation or any matter relating to or arising from the obligation on the basis that the holder, beneficial owner, subscriber, or affiliate is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory; or

(3) any obligation of the corporation on the basis of the failure of the corporation to observe any corporate formality, including the failure to:

(2) Did the bankruptcy court err when it held that Husky could not prevail under 11 U.S.C. § 523(a)(2)(A) because Husky had failed to prove a fraudulent misrepresentation by Ritz that Husky relied upon?

(3) Did the bankruptcy court err when it held that Husky could not prevail under 11 U.S.C. § 523(a)(6) because Ritz's fraudulent transfers of Chrysalis's cash were not a willful or malicious injury to Husky?

9 at p. 7 (electronic numbering).

After careful review of the record, the briefs, and the applicable law, the Court affirms the bankruptcy

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(A) comply with this code or the certificate of formation or bylaws of the corporation; or

(B) observe any requirement prescribed by this code or the certificate of formation or bylaws of the corporation for acts to be taken by the corporation or its directors or shareholders.

(b) Subsection (a)(2) does not prevent or limit the liability of a holder, beneficial owner, subscriber, or affiliate if the obligee demonstrates that the holder, beneficial owner, subscriber or affiliate caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder, beneficial owner, subscriber, or affiliate.

"Affiliate" means "a person who controls, is controlled by, or is under common control of another person." Tex. Bus. Org.Code § 1.002(1).

"[L]iability of the corporations's shareholder/owner is exclusive and preempts any other liability imposed for that obligation under common law or otherwise." Tex. Bus. Org.Code § 21.224.

court's memorandum and order for the reasons indicated below.

Standard of Review

This Court has jurisdiction over appeals from "final judgments, orders and decrees" of a bankruptcy court under 28 U.S.C. § 158(a)(1). *See In re Berman-Smith*, 737 F.3d 997, 1000 (5th Cir. 2013). Under 28 U.S.C. § 157(b)(1), a bankruptcy court may hear and determine "core proceedings." Actions to determine the dischargeability of a debt are core proceedings under 28 U.S.C. § 157(b)(2)(B),(I), and (O), and such determinations are exclusively within the jurisdiction of the bankruptcy court, 28 U.S.C. § 523(a)(2). In "reviewing a bankruptcy court's decision in a 'core proceeding,' a district court functions as a[n] appellate court." *Webb v. Reserve Life Ins. Co. (In re Webb)*, 954 F.2d 1102, 1103–04 (5th Cir. 1992).

Conclusions of law of the bankruptcy court are reviewed *de novo*. *In re Chesnut*, § 422 F.3d 298, 301 (5th Cir. 2005). Mixed questions of law and fact are also reviewed *de novo*. *In re San Patricio Cnty. Cmty. Action Agency*, 575 F.3d 553, 557 (5th Cir. 2009), *citing In re Seven Seas Petroleum, Inc.*, 522 F.3d 575, 583 (5th Cir. 2008).

This Court reviews findings of fact for clear error. *In re Lothian Oil, Inc.*, 650 F.3d 539, 542 (5th Cir. 2011). "A finding of fact is clearly erroneous when the appellate court, viewing the evidence in its entirety, 'is left with a firm and definite conviction that a mistake has been committed.'" *Bertucci Contracting Corp. v. M/V ANTWERPEN*, 465 F.3d 254, 258–59 (5th Cir. 2006). "If the district court's finding is plausible in light of the record viewed as a whole, the court of appeals cannot reverse even

though, if sitting as the trier of fact, it would have weighed the evidence differently." *In re San Patricio Cnty. Cmty. Action Agency*, 575 F.3d 553, 557 (5th Cir. 2009), *citing Anderson*, 470 U.S. at 573–74. "If there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous." *Anderson*, 470 U.S. at 574. The appellant bears the burden of showing that a finding of fact by the bankruptcy court is clearly in error. *In re Davis*, No. 07–33986–H3–7, 2012 WL 2871662, at *3 (S.D. Tex. July 10, 2012) (*citing Perry v. Dearing*, 345 F.3d 303, 309 (5th Cir. 2003)), *aff'd*, 538 Fed.Appx. 440 (5th Cir. 2013), *cert. denied*, —— U.S. –– (2014).

Relevant Law

A bankruptcy court has exclusive jurisdiction to decide whether a debt is nondischargeable as defined by the bankruptcy law. *Matter of Dennis*, 25 F.3d 274, 278 (5th Cir. 1994). As a creditor claiming nondischargeability, Appellant bears the burden of proving by a preponderance of the evidence that the debt is exempt from discharge. *In re Gauthier*, 349 Fed.Appx. 943, 945 (5th Cir. 2009), *citing Gen. Elec. Capital Corp. v. Acosta (In re Acosta)*, 406 F.3d 367, 372 (5th Cir. 2005). "Intertwined with this burden is the basic principle of bankruptcy that exceptions to discharge must be strictly construed against a creditor and liberally construed in favor of a debtor so that the debtor may be afforded a fresh start." *FNFS Ltd. v. Harwood (In re Harwood)*, 637 F.3d 615, 619 (5th Cir. 2011), *citing Hudson v. Raggio & Raggio (In re Hudson)*, 107 F.3d 355, 356 (5th Cir. 1997). Unless the creditor proves that an exception to discharge applies, the creditor can only collect against the

bankruptcy estate. *In re Gauthier*, 349 Fed.Appx. at 945.

11 U.S.C. § 523(a)(2)(A)

Section 523(a)(2)(A), exempting from discharge a debt obtained by false pretenses, a false representation or actual fraud, provides that

> a discharge under § 727 of this title does not discharge an individual debtor from any debt— for money, property, or services, ... to the extent obtained by—false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insiders's financial condition.

Although other Courts of Appeals apply the same standard to all § 523(a)(2)(A) claims, the Fifth Circuit in the past has differentiated the elements of "actual fraud" and of "false pretenses and false representations" chronologically, based on whether the representation was made about a past or a future matter. *RecoverEdge LP v. Pentecost*, 44 F.3d 1284, 1291 (5th Cir. 1995). A false representation or false pretense under § 523(a)(2) must depict current or past facts, and the creditor must show by a preponderance of the evidence (1) a knowing and fraudulent falsehood, (2) describing past or current facts, that (3) was relied upon by the other party. *Id.* at 1292–93, *citing Allison v. Roberts (In re Allison)*, 960 F.2d 481, 483 (5th Cir. 1992). *See also Bank of La. v. Bercier (In re Bercier)*, 934 F.2d 689, 692 (5th Cir. 1991) ("'A mere promise to be executed in the future is not sufficient to make a debt nondischargeable, even though there is no excuse for a subsequent breach.'"), *citing 3 Collier on Bankruptcy* 15th Ed. ... § 523.08. A false

representation involves an express statement, while "false pretenses may be based on misleading conduct without an express statement." *Wallace v. Davis (In re Davis)*, 377 B.R. 827, 834 (E.D. Tex. 2007). Both false pretenses and false representations entail intentional conduct intended to create and develop a false impression. *Id.*, *citing Still v. Patten (In re Patten)*, 225 B.R. 211, 215 (Bankr. Or. 1998).

"'Actual fraud, by definition consists of any deceit, artifice, trick or design involving direct and active operation of the mind, used to circumvent and cheat another—something done or omitted with the design of perpetrating what is known to be a cheat or deception.'" *RecoverEdge*, 44 F.3d at 1293, *quoting 3 Collier on Bankruptcy* ¶ 523.08, at 523–57 to 523–58. For actual fraud, the creditor must prove the debtor had the intent to deceive and that the fraud proximately caused the loss by the creditor. *RecoverEdge*, 44 F.3d at 1293. To prevail on a claim that a debt is nondischargeable under 11 U.S.C. § 523(a)(2)(A) because of actual fraud, a creditor must show by a preponderance of the evidence that (1) the debtor made a misrepresentation, (2) the debtor knew the misrepresentation was false at the time he made it, (3) the representation was made with the intent to deceive the creditor, (4) the creditor actually and justifiably relied[7] on the representation, and (5) the creditor suffered a loss as a proximate result of its reliance. *In re Acosta*, 406 F.3d at 372. Moreover unlike false pretenses or false representation, actual fraud can focus on a promise of a future performance

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[7] The Fifth Circuit does not require the creditor to have "reasonably" relied on the representation. *RecoverEdge*, 44 F.3d at 1293 n. 17.

made with the intent not to perform. *Trenholm v. Ratcliff*, 646 S.W.2d 927, 930 (Tex. 1983). "Debts that satisfy the third element, the scienter requirement, are debts obtained by frauds involving 'moral turpitude or intentional wrong, and any misrepresentations must be knowingly and fraudulently made.'" *In re Acosta*, 406 F.3d at 372, *citing In re Martin*, 963 F.2d 809, 813 (5th Cir. 1992). The court may infer an intent to deceive from "'reckless disregard for the truth or falsity of a statement, combined with the sheer magnitude of the resultant misrepresentation.'" *Id.*, quoting *In re Norris*, 70 F.3d 27, 30 n. 12 (5th Cir. 1995), *citing In re Miller*, 39 F.3d 301, 305 (11th Cir. 1994). Where the speaker has an unreasonable but honest belief that a representation is true and has information justifying that it is, he does not have an intent to deceive, i.e., "a 'dumb' but honest" defendant does not have scienter. *Id.*, *citing Palmacci v. Umpierrez*, 121 F.3d 781, 788 (1st Cir. 1997). Exceptions to discharge under § 523 should be construed in favor of the debtor. *Fezler v. Davis (In re Davis)*, 194 F.3d 570, 573 (5th Cir. 1999).

As will be discussed, in the wake of *Field v. Mans*, 516 U.S. 59, 71–72 (1995) it is uncertain whether the Fifth Circuit's earlier distinction among the three terms survived *Field*. *In re Mercer*, 246 F.3d at 394–95.

"It is well settled that silence can create a false impression, providing the basis for a misrepresentation that is actionable under § 523(a)(2)(A)." *In re Demarest*, 176 B.R. 917, 920 (Bankr. W.D. Wash.1995), *aff'd*, 124 F.3d 211 (9th Cir. 1997), *cert. denied*, 525 U.S. 827 (1998). *See also In re Lau*, No. 11–40284, Adv. 11–4203, 2013 WL

5935616, at *18 (Bankr. E.D. Tex. Nov. 4, 2013) ("The failure to disclose a material fact when one has a duty to do so is sufficient grounds for nondischargeability for fraud under § 523(a)(2)(A) of the Bankruptcy Code."). Whether there is a duty to disclose is a question of law for the court. *Id.*, *citing In re Int'l Profit Assocs., Inc.*, 274 S.W.3d 672, 678 (Tex. 2009). The Fifth Circuit recognizes such a duty in fiduciary or confidential relationships and outside of a fiduciary or confidential relationship when a party voluntarily discloses some, but not all, material factors or where the speaker fails to disclose new information that makes an earlier representation misleading or untrue. *In re Lau*, 2013 WL 5935616, at *19.

In Texas to show fraud by nondisclosure, a subspecies of fraud, the creditor must prove "(1) a party conceals or fails to disclose a material fact within that party's knowledge, (2) the party had a duty to disclose the fact, (3) the party knows that the other party is ignorant of the fact and does not have an equal opportunity to discover the truth, (4) the party intends to induce the other party to take some action by concealing or failing to disclose the fact, (5) the other party justifiably relies on the nondisclosure, and (6) the other party suffers injury as a result of acting without knowledge of the undisclosed fact." *In re Edelman*, No. 13–31182–BJH, Adv. 13–03126–BJH, 2014 WL 1796217, at *34 (Bankr. N.D. Tex. May 6, 2014), *citing Bradford v. Vento*, 48 S.W.3d 749, 755–56 (Tex. 2001). Plaintiffs must prove these elements by a preponderance of the evidence. *Id.*

A fact is material if "'disclosure of the fact would likely affect the conduct of a reasonable person

concerning the transaction in question.'" *In re Lau*, 2013 WL 5935616, at *18.

Fraud by nondisclosure requires proof of a duty to disclose. *Bright v. Addison*, 171 S.W.3d 588, 599 (Tex.App.—Dallas 2005, pet. dism'd, pet. denied). Texas recognizes that a duty to disclose may arise in four circumstances: "(1) when there is a fiduciary relationship; (2) when one voluntarily discloses information, the whole truth must be disclosed; (3) when one makes a representation, new information must be disclosed when the new information makes the earlier misrepresentation misleading or untrue; and (4) when one makes a partial disclosure and conveys a false impression." *Hoggett v. Brown*, 971 S.W.2d 472 (Tex.App. —Houston [14th Dist.] 1997), citing *Formosa Plastics Corp. v. Presidio Engineers and Contractors, Inc.*, 941 S.W.2d 138, 146–47 (Tex.App.—Corpus Christi 1995), rev'd on other grounds, 960 S.W.2d 41 (1997).

Justifiable reliance requires evidence that the plaintiff actually relied on the false representations and that its reliance was justified under the circumstances. *In re Lau*, 2013 WL 5935616, at *20, *citing First Horizon Home Loan Corp. v. Apostle (In re Apostle)*, 467 B.R. 433, 443 (Bankr. W.D. Mich. 2012). Justifiable reliance is a lower standard than reasonable reliance: it does not require the plaintiff to prove reasonableness, nor does it impose a duty to investigate unless the falsity is easily apparent or there are red flags indicating that reliance is not warranted. *Id., citing First Am. Title Ins. Co. v. Lett (In re Lett)*, 238 B.R. 167, 186 (Bankr. W.D. Mo. 1999); *Guion v. Sims (In re Sims)*, 479 B.R. 415, 425 (Bankr. S.D. Tex. 2012); and *Baker v. Sharpe (In re Sharpe)*, 351 B.R. 409, 423 (Bankr. N.D. Tex. 2005) (A plaintiff

"may not blindly rely upon a misrepresentation, the falsity of which would be obvious to the plaintiff had he or she used her senses to make a cursory examination or investigation. '[O]nly where, under the circumstances, the facts should be apparent to a person of the plaintiff's knowledge or intelligence from a cursory glance, or where the plaintiff has discovered something that should serve as a warning that he is being deceived, is [the plaintiff] required to make an investigation of his own.'"), *citing Field v. Mans*, 516 U.S. 59, 71–72 (1995). Justifiable reliance is not an objective standard: to determine if reliance is justified the court looks at the circumstances of an individual case and the traits of a particular plaintiff. *Id.*, *citing Manheim Automotive Financial Services, Inc. v. Hurst (In re Hurst)*, 337 B.R. 125, 133–34 (Bankr. N.D. Tex. 2005), and *Field v. Mans*, 516 U.S. 59, 70–71 (1995) (Justifiable reliance incorporates "the qualities and characteristics of the particular plaintiff and the circumstances of the particular case, rather than of the application of a community standard of conduct in all cases.").

11 U.S.C. § 523(a)(6)

Section 523(a)(6) of the Federal Bankruptcy Code bars discharge of debt incurred for "willful and malicious injury by the debtor to another entity or to the property of another entity." An injury is "willful and malicious" for purposes of § 523(a)(6) "where either (1) there is an objective substantial certainty of harm or (2) there exists a subjective motive to cause harm." *In re Edelman*, 2014 WL 1796217, at *42; *In re Miller*, 156 F.3d at 606. The statute covers physical damage and harm to personal or property rights. *In re Edelman*, 2014 WL 1796217, at *42.

Where the primary debt is nondischargeable under § 523(a)(2)(A) and/or (a)(6), related ancillary awards including attorney's fees and interest are also nondischargeable. *In re Edelman*, 2014 WL 1796217, at *43.

Liability of Owner or Shareholder of a Corporation for Breach of Contract Claims

"The corporate form normally insulates shareholders, officers and directors from liability for corporate obligations...." *Castleberry v. Branscum*, 721 S.W.2d 270, 271 (Tex. 1986), superseded in part by former Bus. Corp. Act art. 2.21, recodified at Tex. Bus. Org.Code Ann. § 21.223. Traditionally, the alter ego doctrine is relevant "when there is such unity between corporation and individual that the separateness of the corporation has ceased and holding only the corporation liable would result in injustice." *Castleberry*, 721 S.W.2d at 272. Castleberry, which required only a showing of constructive fraud to pierce the corporate veil, identified seven theories for piercing the corporate veil to hold individual shareholders liable for corporate acts: (1) the corporate fiction is used to perpetrate fraud ("a sham to perpetuate a fraud"); (2) the corporation is organized and operated as a mere tool or business conduit of another corporation (alter ego); (3) the corporate fiction is used to evade an existing legal obligation; (4) the corporate fiction is used to achieve or perpetuate monopoly; (5) the corporate fiction is used to circumvent a statute; (6) the corporate fiction is relied upon as a protection of crime or to justify wrong; and (7) where the corporation is inadequately capitalized. 721 S.W.2d at 272. Alter ego "is shown from the total dealings of the corporation and the individual, including the

degree to which corporate formalities have been followed and corporate and individual property have been kept separately, the amount of financial interest, ownership and control the individual maintains over the corporation, and whether the corporation has been used for personal purposes." *Castleberry*, 721 S.W.2d at 272.

Nevertheless, to limit Castleberry, in 1989 the Legislature placed strict restrictions on a contract claimant's ability to pierce the corporate veil; now codified at § 21.223 of the Texas Business Organizations Code, the statute states,

> (a) A holder of shares [or] owner of any beneficial interest in shares ... may not be liable to the corporation or its obligees with respect to ...
>
> > (2) any contractual obligation of the corporation or any matter relating to or arising from the obligation on the basis that the holder [or] beneficial owner is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud or other similar theory....
>
> (b) Subsection (a)(2) does not prevent or limit the liability of a holder [or] beneficial owner ... if the obligee demonstrates that the ... beneficial owner ... caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder [or] beneficial owner....

Any such liability for an obligation on behalf of the corporation "is exclusive and preempts any other liability imposed for that obligation under common

law or otherwise." *Id.* § 21.224; *Lone Star Air Systems, Ltd. v. Powers*, 401 S.W.3d 855, 862–63 (Tex.App.—Houston [14th Dist.] 2013). In a breach of contract case, section 21.223 requires proof of actual fraud to pierce the corporate veil on the basis of alter ego, i.e., the shareholder caused "the corporation to be used for the purpose of perpetrating and did perpetrate a fraud." *Rimade*, 388 F.3d at 143. "Actual fraud" "involves dishonesty of purpose or intent to deceive." Tex. Bus. Corp. Act Ann., art. 221(A)(2) ("[T]he ... owner ... caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the ... owner....". Thus § 21.223 overruled *Castleberry* to the degree that a failure to observe corporate formalities is no longer a factor in proving alter ego in contract claims, and it eliminated constructive fraud as a means to pierce the corporate veil. [8] *Western Horizontal Drilling, Inc. v. Jonnet Energy Corp.*, 11 F.3d 65, 67–68 & n. 4 (5th Cir. 1994) (narrowing *Castleberry*'s list to "three broad categories in which a court may pierce a corporate veil" under Texas law: (1) the corporation was the alter ego of its owners and/or shareholders; (2) the corporation was used for illegal purposes; and

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[8] *See also Hidden Values, Inc. v. Wade*, Civ. A. No. 3:11–CV1917–L, 2012 WL 1836087, at *4 n. 4 (N.D. Tex. May 18, 2012) ("Section 21.223 is the amended, codified version of article 2.21 of the Texas Business Corporation Act and was adopted by the Texas legislature to limit a shareholder's personal liability for the contractually related obligations of a corporation and requires a showing that 'actual fraud,' rather than some lower threshold of wrongful conduct, has been perpetrated through use of the corporate form for the direct personal benefit of the corporations's shareholder that is sought to be charged with liability.").

(3) the corporation was used as a sham to perpetrate fraud); *Rimade Ltd. v. Hubbard Enters., Inc.*, 388 F.3d 138, 143 (5th Cir. 2004). "In other words, alter ego or other similar theories may be used to pierce the corporate veil only if (1) actual fraud is shown, and (2) it was perpetrated primarily for the direct personal benefit of the holder." *Ocram, Inc. v. Bartosh*, 2012 WL 4740859, *3 (Tex.App.—Houston [1st Dist.] Oct. 4, 2012).

Actual fraud is "the misrepresentation of a material fact with the intention to induce action or inaction, reliance on the misrepresentation by a person who, as a result of such reliance, suffers injury." *Trustees of Northwest Laundry and Dry Cleaners Health & Welfare Trust Fund v. Burzynski*, 27 F.3d 153, 157 (5th Cir. 1994), *cert. denied*, 513 U.S. 1155 (1995). The elements of actual fraud are "a material misrepresentation, which was false, and which was either known to be false when made or was asserted without knowledge of the truth, which was intended to be acted upon, which was relied upon, and which caused injury." *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 688 (Tex. 1990). If an obligee shows that the shareholder used the corporation to perpetrate fraud on the obligee for the shareholder's direct personal benefit, the shareholder is liable under § 21.223(b). *Willis v. Donnelly*, 199 S.W.3d 262, 272 (Tex. 2006) (statute precludes the use of common law veil-piercing theories).

Husky's Opening Brief (# 9)

Husky is a Colorado seller of electronic device components which sold to Chrysalis, a manufacturer of electronic circuit boards, from 2003 to 2007 certain

goods for $163,999.38, which debt Chrysalis failed to pay.

Husky sued Chrysalis in this district in May 2009, *Husky Int'l Electronics, Inc. v. Ritz*, H–09–1532, asserting that Ritz was personally liable under Texas Business Organizations Code § 21.223(b) for Chrysalis's $163,999.38 corporate debt to Husky. In December of that year Ritz filed an involuntary bankruptcy petition. # 9, Appendix A. On March 31, 2010, Husky commenced the adversary proceeding from which this appeal is taken, objecting to the discharge of that corporate debt under the exceptions set out in 11 U.S.C. § 523(a)(2), (a)(4),[9] and (a)(6). *Id.*

Regarding appellate issue one (Did the bankruptcy court err when it ignored that fraudulent transfers pursuant to Texas Business and Commerce Code § 24.005 are "actual frauds within the meaning of Texas Business Organizations Code § 21.223(b)?"), Judge Bohm found that at all relevant times, Ritz had financial control of Chrysalis, was a director of Chrysalis, owned a minimum of 30% of Chrysalis's common stock, was not paying its bills as they came due, and Chrysalis's debts were greater than all of its

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[9] Title 11 U.S.C. 523(a)(4) provides that "[a] discharge under section 727 ... does not discharge an individual from any debt for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." Its purpose is to deal with circumstances where "debts [are] incurred through abuses of fiduciary positions and through active misconduct whereby a debtor has deprived others of their property by criminal acts; both classes of conduct involve debts arising from the debtor's acquisition or use of property that was not the debtor's." *Miller v. J.D. Abrams, Inc. (In re Miller)*, 156 F.3d 598, 602 (5th Cir. 1998), *citing In re Boyle*, 819 F.2d 583, 588 (5th Cir. 1987). As noted, Husky did not appeal the ruling denying this claim.

assets at fair valuation. Given the last two facts, Chrysalis qualified as insolvent under Texas Business & Commerce Code § 24.003(a) and (b).[10]

Judge Bohm further found that between November 2006 and May 2007, when Chrysalis stopped doing business, Ritz caused the insolvent Chrysalis to transfer the following funds to eight entities owned and controlled by Ritz, resulting in Husky's damages

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[10] Section 24.003(a) and (b) provided,

> (a) A debtor is insolvent if the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation.
>
> (b) A debtor who is generally not paying a debtor's debts as they become due is presumed to be insolvent.

A debtor is insolvent under the Uniform Fraudulent Transfer Act ("TUFTA") if it meets this definition after transfers. Corpus v. Arriaga, 294 S.W.3d 629, 637 (Tex. App.—Houston [1st Dist.] 2009). Texas Business & Commerce Code § 24.006, "Transfers Fraudulent as to Present Creditors," provides,

> (a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at the time or the debtor became insolvent as a result of the transfer or obligation.
>
> (b) A transfer made by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at that time, and the insider had reasonable cause to believe that the debtor was insolvent.

of $163,999.38, i.e., that amount Chrysalis owed Husky for the goods Husky shipped to Chrysalis. Judge Bohm also ruled that Chrysalis did not receive a reasonably equivalent value in exchange for the transfers. The following transfers are identified:

1. $677,622.00 to Ritz's ComCon Manufacturing Services, Inc. a/k/a VirTra Merger Corporation;

2. $121,831.00[11] to Ritz's CapNet Securities Corporation;

3. $52,600.00 to Ritz's CapNet Risk Management, Inc.;

4. $172,100.00 to Ritz's Institutional Capital Management, Inc. and Ritz's Institutional Insurance Management, Inc.;

5. $99,386.00 to Ritz's Dynalyst Manufacturing Corporation;

6. $11,240.00 to Ritz's CapNet Advisors Incorporated.

Moreover Judge Bohm found,

> At all relevant times, the Debtor owned: (1) 30% of Chrysalis; (2) 85% of CapNet Securities Corporation; (3) 100% of CapNet Risk Management, Inc.; (4) 100% of Institutional Insurance Management, Inc.; (5) 40% of Institutional Capital Management, Inc.; (6) 25% of Dynalyst Manufacturing Corporation; and (7) 20% of Clean Fuel International Corp., a/k/a Gulf Coast Fuels. 459 B.R. at 628, ¶ 14.

Under TUFTA, Tex. Bus. & Com.Code § 24.005(a)(2)(B) (see footnote 4), if the debtor made a

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[11] The Complaint alleged $121,821.00.

transfer without receiving a reasonably equivalent value in exchange and the debtor "intended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor's ability to pay as they became due," the transfer is fraudulent as to the creditor. Judge Bohm found there was no doubt that the evidence proved that the transfers of $1.2 million were fraudulent as to Husky and possibly other creditors.

At a hearing on July 13, 2011, however, the bankruptcy court held that "actual fraud" under Texas Business Organizations Code § 21.223(b) can only be fraud by misrepresentation, the first issue challenged by Husky. Judge Bohm determined that "[n]o exhibits were introduced and no testimony was adduced indicating that the Debtor made any oral or written representations to Husky inducing Husky to enter into a contract with Chrysalis. The only communication that the Debtor ever had with Husky was a telephone conversation between Husky's founder and president, Nick Davis, and the Debtor **after** the parties had entered into a contract and Husky had already shipped the product to Chrysalis." # 2–13 at pp. 4–5. While Judge Bohm found Ritz "to be a witness with virtually no credibility" and he thought Ritz "drained Chrysalis of a lot of money," because Judge Bohm found that Ritz made no representations to Husky, Husky could not recover its damages for fraud under § 21.223(b). Doc. 20, 7:21–8:11.

In his memorandum opinion, # 2–13, Judge Bohm clearly stated that actual fraud under Texas law is defined as "the misrepresentation of a material fact with intention to induce action or inaction, reliance on the misrepresentation by a person who, as a result

of such reliance, suffers injury." *Id.* at p. 12, *citing Trustees of the N.W. Laundry & Dry Cleaners Health and Welfare Trust Fund v. Burzynski*, 27 F.3d 153, 157 (5th Cir. 1994). He identified the elements of actual fraud in Texas as "(1) the defendant made a representation to the plaintiff; (2) the representation was material; (3) the representation was false; (4) when the defendant made the representation the defendant knew it was false or made the representation recklessly and without knowledge of its truth; (5) the defendant made the representation with the intent that the plaintiff act on it; (6) the plaintiff relied on the representation; and (7) the representation caused the plaintiff injury." *Id.* at pp. 12–13, *citing Shandong Yinguang Chem. Indus. Joint Stock Co. v. Potter*, 607 F.3d 1029, 1032–33 (5th Cir. 2010). He reiterated that "the record is wholly devoid of any such representation made by the Debtor" and concluded that because "Husky's common law fraud cause of action must fail," his claims under § 21.223 and § 523(a)(2)(A) must fail. *Id.* at p. 13.

At trial Husky contended that the Ritz-directed transfers of $1.2 million from Chrysalis to other Ritz-controlled entities for Ritz's direct personal benefit were fraudulent transfers under TUFTA, Texas Bus. & Com.Code § 24.005(a). In this appeal, relying heavily on *McClellan v. Cantrell*, 217 F.3d 890, 893 (7th Cir. 2000) (opining that allowing a debtor, who fraudulently transferred valuable property in order to keep it out of the hands of a creditor, to use bankruptcy to shield herself from liability "is as blatant an abuse of the Bankruptcy Code as we can imagine," and "turns bankruptcy into an engine for

fraud,"[12]), Husky argues that the law does prohibit Ritz from defrauding Husky by the fraudulent transfers despite the absence of a representation by Ritz to Husky. In 1989 the Texas Legislature amended article 2.21 of the Texas Business Corporations Act, amended again in 2011 and now Texas Business Organizations Code § 21.223, and significantly narrowed the bases for corporate veil piercing that had been recognized in *Castleberry*, 721 S.W.2d at 271–72. Husky argues that Judge Bohm erred in holding that actual fraud is limited to fraud by misrepresentation. *Citing McCarthy v. Wani Venture, A.S.*, 251 S.W.3d 573, 591 (Tex.App.—Houston [1st Dist.] 2007, pet. denied) (actual fraud not limited to misrepresentation; affirming jury verdict of actual fraud under § 21.223(b) based on shareholder's fraudulent transfers of cash out of debtor company (applying corporate veil piercing principles to LLCs) to other companies in which the shareholder had "direct ownership and/or financial interest," i.e., using a corporation as "a sham to perpetuate a fraud").

TUFTA also makes a transfer fraudulent as to a creditor where it is made "with actual intent to hinder, delay, or defraud any creditor of the debtor." Tex. Bus. & Com.Code § 24.005(a)(1). Judge Bohm found two badges of fraud[13] in the transfers of the

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[12] Doc. 20 in Adversary Proceeding 10–3156.

[13] *See Mladenka v. Mladenka*, 130 S.W.3d 397, 405 (Tex. App.—Houston [14th Dist.] 2004, no pet.) (Because direct proof of fraud is usually not available, circumstantial evidence, i.e., "badges of fraud," may be used to determine intent under § 24.005(a)(1): whether "(1) the transfer or obligation was to an insider; (2) the debtor retained possession or control of the property transferred after the transfer; (3) the transfer or obligation was concealed;

$1.2 million, establishing actual intent under TUFTA § 24.005(a)(1): the value of consideration received by Chrysalis was not reasonably equivalent to the asset's value; and Chrysalis was insolvent when Ritz made the transfers. The evidence established two others: the transfers were made between November 2006 and May 2007 to "insiders" because Ritz was a director, officer or person in control of each of the transferee corporations; and Chrysalis was threatened with suit by Husky president Nick Davis during a conversation with Ritz on or around January 12, 2007 and Davis filed suit on January 23, 2007.

Husky also contends that it proved that Ritz perpetrated the fraudulent transfers of $1.2 million for his "direct personal benefit." Fraudulent transfer of assets to a corporation owned 100% by the individual defendant has been found to be a "direct personal benefit." *Nick Corp. v. JNS Aviation, LLC (In re JNS Aviation, LLC)*, 376 B.R. 500, 530–31 (Bkrtcy. N.D. Tex.2007) (owners of an aviation

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(4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit; (5) the transfer was of substantially all the debtor's assets; (6) the debtor absconded; (7) the debtor removed or concealed the assets; (8) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of obligation incurred; (9) the debtor was insolvent or became insolvent shortly after the transfer was incurred; (10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and (11) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor."). § 24.005(b). If several of the badges of fraud are found, they can give rise to an inference of fraud. *Roland v. U.S.*, 838 F.2d 1400, 1403 (5th Cir. 1988).

company against which a creditor obtained a default judgment, transferred the aviation company's assets to a newly formed entity to avoid satisfying the judgment; affirming bankruptcy court's findings of actual fraud and direct personal benefit). The same where the defendant had direct ownership and/or a financial interest in various corporate entities that received diverted sums due to another undercapitalized entity. *McCarthy*, 251 S.W.3d 573. "Any benefit" bestowed on the company is a personal benefit to the majority owner and controller. *David W. Morrison Western Builders of Amarillo, Inc. v. Morrison (In re David W. Morrison Western Builders of Amarillo, Inc.)*, 361 B.R. 107, 120 (Bkrtcy. W.D. Tex. 2007) (concluding under article 2.21(a)(2) that president and majority shareholder of an excavation company, Morrison, received direct personal benefit from misrepresenting the dire financial health of the corporation to obtain a contract for the corporation to keep the corporation in business and draw his substantial salary and maintain his lifestyle), *aff'd*, 555 F.3d 473 (5th Cir. 2009).

Husky argues that Ritz's transfer of $1.2 million of the insolvent Chrysalis's cash to entities of which Ritz owned and/or controlled substantial percentages comprised a "direct personal benefit" to Ritz within the meaning of § 21.223(b). Ritz even testified at trial that the transfers personally benefitted him. # 2–9, p. 66:19–21 (transfers to CapNet Securities); 66:23–67:6 (transfers to Clean Fuels or Gulf Coast Fuels); 67:7–10 ($96,000 transferred from Chrysalis to Dynalyst Manufacturing); 67:11–17 (all $1.2 million). Husky argues that the bankruptcy court erred as a matter of law in failing to recognize these

fraudulent transfers were "actual frauds" within the meaning of Tex. Bus. Orgs.Code § 21.223(b).

Regarding the second issue of law, (did the bankruptcy court err when it held that Husky could not prevail under 11 U.S.C. § 523(a)(2)(A) because Husky had failed to prove a fraudulent misrepresentation by Ritz that Husky relied upon?), Husky maintains that the exception to discharge in bankruptcy "for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by false pretenses, a false representation, or actual fraud" under 11 U.S.C. § 523(a)(2)(A) is also "not limited to 'fraudulent misrepresentation.'" *McClellan*, 217 F.3d at 892–93 (reversing bankruptcy court and holding "the statute makes clear that actual fraud is broader than misrepresentation") (citing 4 *Collier on Bankruptcy* § 523.08[1] [e], p. 523–45. (15th ed., Lawrence P King, ed., 2000), defining actual fraud as "any deceit, artifice, trick, or design involving direct and active operation of the mind, used to circumvent and cheat another").[14] The Seventh Circuit opined, "Nothing in the Supreme Court's opinion [in *Field v. Mans*, 516 U.S. 59, 68 (1995)] suggests that misrepresentation is the only type of fraud that can give rise to a debt that is not dischargeable under section 523(a)(2)(A)." *Id.* at 892. Although misrepresentation is "the most common type of fraud," cases holding that fraud equals misrepresentation are often "cases in which the only fraud charged was misrepresentation." *Id.* In finding that the fraudulent transfers asserted in

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[14] *In accord, Mellon Bank, N.A. v. Vitanovich (In re Vitanovich)*, 259 B.R. 873, 876–78 (6th Cir. BAP 2001); *Diamond v. Vickery (In re Vickery)*, 488 B.R. 680, 691 (10th Cir. BAP 2013).

McClellan were actual frauds that would justify a denial of the debtor's discharge under § 523(a)(2)(A), the Seventh Circuit wrote,

> No learned inquiry into the history of fraud is necessary to establish that it is not limited to misrepresentations and misleading omissions. "Fraud is a generic term, which embraces all the multifarious means which human ingenuity can devise and which are resorted to by one individual to gain an advantage over another by false suggestions or by the suppression of truth. No definite and invariable rule can be laid down as a general proposition defining fraud, and it includes all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated." [citation omitted]
>
> *Id.* at 893 ("here the transfer involved actual fraud" because "the debtor's brother was deliberately attempting to thwart *McClellan*'s effort to collect the debt due him"). Thus the bankruptcy court erred as a matter of law in limiting the fraud to misrepresentation, insists Husky.

Relating to Husky's final issue (Did the bankruptcy court err when it held that Husky could not prevail under 11 U.S.C. § 523(a)(6) because Ritz's fraudulent transfers of Chrysalis's cash were not a willful or malicious injury to Husky?), Husky notes that the bankruptcy judge found that the record was "wholly devoid" of evidence that Ritz willfully and maliciously injured Husky or Husky's property and therefore could not prevail under 11 U.S.C.

§ 523(a)(6). [15] Husky finds that this conclusion conflicts with the bankruptcy court's findings about Ritz's fraudulent transfers,[16] that Ritz "orchestrated" the fraudulent transfers, that Ritz "drained Chrysalis of a lot of money," [17] i.e., $163,999.38, and Judge Bohm's stated belief that "what Mr. Ritz did should not be allowed." [18] Judge Bohm criticized Husky's complaint for making only a "glancing reference" to § 523(a)(6) and Husky for failing to do any briefing on the statute. Husky states that its briefing focused on Ritz's fraudulent transfers, which it argues should except Ritz's debt from discharge under either § 523(a)(2) and § 523(a)(6). Husky further notes that a number of courts suggest that when a debtor's conduct is willful and malicious, the creditor should seek nondischargeability under both statutes. *See, e.g., Stokes v. Ferris*, 150 B.R. 388, 392 (W.D. Tex. 1992); *McClellan*, 217 F.3d at 896 (Ripple, J., concurring). A wrongful act done intentionally, which necessarily produces harm or which has a substantial certainty of causing harm and is without just cause or excuse is "willful and malicious" within the meaning of § 523(a)(6). *Miller v. J.D. Abrams, Inc.*, 156 F.3d at 601.

Husky urges that Judge Bohm's finding that there was no proof of willful and malicious injury appears to be based on his erroneous conclusion that a fraudulent transfer is not an "actual fraud" under Tex. Bus. Orgs.Code § 21.223(b). Ritz's draining

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[15] App. A, p. 16.

[16] App. A, pp. 3–4. ¶¶ 7–13.

[17] Doc. 20, 7:21–8:11.

[18] *Id.*, 11:16–19.

Chrysalis's cash and transferring it to his other companies to avoid paying Husky the $163,999.38 that Chrysalis owed Husky is an "actual fraud" under § 21.223(b), and therefore a "malicious and willful tortious conduct." Thus Ritz's debt to Husky should be excepted from discharge under § 523(a)(6).

Appellee's Brief (# 10)

Ritz objects to Husky's statement of facts first with regard to Husky's characterization that the transfers of cash from Chrysalis to seven entities, all active business operations, were made without Chrysalis's receiving equivalent value. Ritz concedes that the transfers were made, authorized by him, but argues that they were repayments of loans that these entities extended to Chrysalis on a continuous basis to finance its business operations. Ritz provides details about each. # 10 at pp. 1–6. He also claims that before 2006 there was a plan to merge two of them (ComCon a/k/a Virtra Merger and Dynalyst Manufacturing) with Chrysalis into a single business operated by ComCon, which accounted for a number of the loans and repayments, but the proposed merger failed in 2007.

Next, Ritz addresses the § 523(a)(2) claims. Acknowledging that Judge Bohm correctly stated the traditional elements of a claim for "actual fraud" under Texas common law (Mem. Op. at pp. 12–13), the Fifth Circuit has stated the same elements for a § 523(a)(2) dischargeability claim, but Ritz describes the elements slightly differently: the objecting creditor must show by preponderance of the evidence that (1) the debtor made representations (2) that the debtor knew were false when he made them, (3) the representations were made with the intention and

purpose to deceive the creditor, (4) the creditor relied on the representations, and (5) the creditor suffered losses as a proximate result of the representations. *RecoverEdge*, 44 F.3d at 1293. Observing that a claim for "actual fraud" can be based on an affirmative misrepresentation, on a failure to disclose if there is a duty to disclose, or on an affirmative concealment of material facts, Ritz maintains that there is no evidence that he made any misrepresentations or intentionally concealed any material facts from Husky. Ritz had no duty to disclose, first because he never made any partial disclosures to and he did not have a fiduciary relationship with Husky. Furthermore, such a claim must fail because Husky never pleaded a failure to disclose in the complaint or joint pretrial order. Instead the Complaint alleged that the checks signed by Ritz and given to Husky were bad, but even that claim was dropped at trial when it became apparent that Ritz's father had signed the checks. Husky waived any claim for failure to disclose by not pleading it or arguing it during trial. Second, the duty to disclose claim fails as a matter of law because such a duty arises only where there is a partial disclosure or a fiduciary duty. Ritz had no contact, dealings or miscommunications with Husky or any of its representatives until mid-January 2007, after Chrysalis had shipped all of its products to Chrysalis and Ritz attempted to resolve the dispute, so he did not make a partial disclosure that might trigger such a duty to disclose. Judge Bohm found there was no fiduciary relationship between Ritz and Husky, and Husky did not contest that ruling on appeal.

Actual fraud "'consists of any deceit, artifice, trick or design involving direct and active operation of the

mind, used to circumvent and cheat another—something said, done or omitted with the design of perpetrating what is known to be a cheat or deception.'" *RecoverEdge*, 44 F.3d at 1293, *quoting 3 Collier on Bankruptcy* ¶ 523.08 at 523–57 to 523–58 (footnote omitted). Husky's claims that Ritz engaged in an "unlawful artifice, device, or scheme to defraud" Husky fail because Ritz (1) did not make any false representations and failed to disclose or to intentionally conceal facts; (2) had no communications, interactions or dealings with Husky; and (3) had no fraudulent intent to deceive that was relied upon by Husky. Furthermore Husky's fraud claim fails as a matter of law because the property obtained by Chrysalis was not obtained because of any fraudulent conduct. Citing cases, Ritz argues that Texas common law as a matter of law shows that the facts of this case could not sustain a claim of actual fraud based on Husky's newly pleaded theory because there is no false representation, nor duty to disclose intentional concealment of a material fact, nor evidence of scienter. While Ritz agrees that "'actual fraud as used in 11 U.S.C. § 523(a)(2)(A) is not limited to intentionally engages in a scheme to deprive or cheat another of property or of a legal right, that debtor has engaged in actual fraud and is not entitled to the fresh start provided by the Bankruptcy Code.'" *In re Lewis*, No. 09–41111, ADV 09–4101, 2010 WL 1379770, at *3 (Bkrtcy. E.D. Tex. Mar. 30, 2010) (*quoting Mellon Bank, N.A. v. Vitanovich (In re Vitanovich)*, 259 B.R. 873, 877 (6th Cir. BAP 2001)), *aff'd, Lewis v. Hill*, No. 4:10cv242, 2011 WL 1299613 (E.D. Tex. Mar. 31, 2011). The Bankruptcy Code "does not permit bankruptcy courts to 'act as roving commission[s] to do equity.'" *Id.* at

*4, *citing Southmark Corp. v. Grosz*, 49 F.3d 1111, 1116 (5th Cir. 1995). Actual fraud is limited to "frauds involving 'moral turpitude or intentional wrong; fraud implied in law which may exist without imputation of bad faith or immorality, is insufficient.'" *RecoverEdge*, 44 F.3d at 1292.

Regarding claims under § 523(a)(6), Husky has the burden to prove that Ritz had either a subjective intent to harm Husky by causing Chrysalis not to pay Husky for the goods Chrysalis had received from Husky or that Ritz engaged in conduct that was substantially certain to harm Husky or its property by not receiving that payment. Ritz contends there is no evidence that he committed an act of willful and malicious injury, or that he had a subjective motive to not pay Husky. Indeed the evidence revealed that Ritz had no part in the purchase of the goods and was unaware of the unpaid debt until after Husky had already sold and delivered the goods to Chrysalis. Nor does the record contain any evidence that Ritz acted with intent to deprive Chrysalis of payment. Second there is no evidence that Husky was objectively certain not to receive payment as a result of the transfers. When the transfers were occurring, Chrysalis was open, operating, manufacturing product, paying employees, and producing income until May 2007, when it stopped.

Ritz insists that Husky's complaint never pleaded or argued any claim for relief under TUFTA, i.e., that Ritz intended to hinder, delay, or defraud creditors or that transfers lacked reasonably equivalent value,[19] but only asked to court to void "all fraudulent

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[19] Tex Bus. & Com.Code §§ 24.005(a) & (b); 24.006(a).

transfers to the extent necessary to satisfy Plaintiff's claims" and in the joint pretrial order stated that "Chrysalis's fraudulent transfer ... was an actual fraud against the rights of Husky and personally benefitted Ritz." [20] Husky did state in closing argument and in its brief (# 90, 10) that Ritz violated TUFTA § 24.006(b) and that this violation automatically supports a finding of actual fraud under Texas and federal common law, but Ritz maintains that the equation is incorrect. While findings of the bankruptcy court could support the legal conclusion that Ritz violated TUFTA, the bankruptcy court rejected these facts when it decided

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[20] Husky responds that transfers are also statutorily fraudulent if made to an "insider" while the debtor was insolvent, as it has alleged under Texas Business and Commerce Code § 24.006(b), which is part of TUFTA. Section 24.006(b) provides,

> A transfer made by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at the time, and the insider had reasonable cause to believe that the debtor was insolvent.

See Telephone Equip. Network v. TA/Westchester Place, 80 S.W.3d 601, 609 (Tex. App.—Houston [1st Dist.] 2002, no pet.) (An "'insider' is an entity whose close relationship with the debtor subjects any transactions made between the debtor and the insider to heavy scrutiny"; courts consider the closeness of the relationship between the transferee and the debtor and whether the transactions were at arm's length), *citing Matter of Holloway*, 955 F.2d 1008, 1009–11 (5th Cir. 1992). "Insider" under the statute includes "a corporation of which the debtor is a director, officer, or person in control." *Holloway*, *id.*, citing Tex. Bus. & Com.Code § 24.002(7). Judge Bohm found that Chrysalis was insolvent at all relevant times and that Ritz was a director, officer or person in control of each of the transferee entities; thus Ritz's eight transfers were fraudulent under Texas law.

that Ritz was not guilty of actual fraud. Judge Bohm properly refused to apply TUFTA concepts relating to fraudulent transfers into the actual fraud analysis under § 523(a)(2).

It is well established that scienter or fraudulent intent is a necessary element of actual fraud, e.g., as in debts obtained by frauds involving "moral turpitude or intentional wrong, and any misrepresentations must be knowingly and fraudulently made," but the bankruptcy judge did not find that Ritz acted with fraudulent intent. *Acosta*, 406 F.3d at 372. Ritz claims that he justified the transfers from Chrysalis to the seven entities by demonstrating that the inbound transfers made by the seven entities (loans to pay Chrysalis's debt and payroll obligations) exceeded the outbound by $924,000, mostly in very close timing to the outbound transfers.

Ritz observes that Husky relies on *McClellan*, 217 F.3d 890 (holding that a damage award issued as a result of a fraudulent transfer made with an actual intent to hinder, delay or defraud creditors qualifies as a type of nondischargeable "actual fraud" under § 523(a)(2)). Ritz argues that *McClellan* demonstrates that Ritz's conduct does not constitute actual fraud. In *McClellan* the Seventh Circuit has a lengthy discussion of the difference between constructive fraud, transfers for less than adequate consideration, and actual fraud, transfers made with an intent to hinder or delay creditors. Only actual fraud satisfies the fraud exception to the dischargeability of debts. *Id.* at 894. As the Seventh Circuit wrote, *id.*,

> The distinction between actual and constructive fraud is the key to this case in two distinct senses. *First.* To transfer property for less than adequate consideration may be desperate, foolish, or imprudent, and the receipt of such a transfer a pure windfall, but neither the transfer nor the receipt is in and of itself dishonest, and so neither is an appropriate ground for refusing to allow the debtor to discharge the debt arising from the transfer and thus to get on with his life without the debt hanging over his head.[21]

Ritz emphasizes that Judge Bohm found that the transfers were made without reasonably equivalent value, a finding that could support a conclusion of constructive fraud. Judge Bohm did not find that Ritz made the transfers with a specific intent to

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[21] Husky objects that Ritz has quoted this section out of context, eliminating key sentences that follow it and qualify it:

> The situation is entirely different, and the debtor's equities and argument for discharge much weaker, when the debtor is guilty of intent to defraud. The purpose of section 523(a)(2)(A) in confining nondischargeability to actual fraud is merely to recognize this difference and thus to exclude constructive fraud.

217 F.3d at 894. The allegation in *McClellan* was that "the transfer involved actual fraud; the debtor's brother was deliberately attempting to thwart McClellan's effort to collect the debt due him," i.e., the brother and sister were acting "in cahoots" and the sister was a "full and equal participant in her brother's fraud." *Id.* Husky contends that the same reasoning applies here, where Ritz was transferring Chrysalis's cash to *himself* by way of companies he owned and controlled; he and his company were "in cahoots" and full and equal participants in the scheme to defraud Husky, so Ritz should be denied a discharge under § 513(a)(2).

hinder or defraud creditors. Moreover, insists Ritz, the record does not support a finding that the transfers were made with an intent to hinder or delay creditors. Instead, the facts demonstrate at most constructive fraud in that (1) the inbound transfers exceeded the outbound by $914,000; (2) Chrysalis continued manufacturing until May 2007; (3) in February 2007 Ritz executed a personal guarantee of an unpaid $133,000 debt for parts owed to Arrow Electronic; and (4) the business operations generated gross income in excess of its ongoing payroll obligations until May 2007.

Husky also cites *McCarthy*, 251 S.W.3d 573, but, according to Ritz, misinterprets it as holding that a fraudulent transfer under Tex. Bus. & Com.Code § 24.001 automatically constitutes actual fraud as contemplated by Texas common law and Tex. Bus. Orgs.Code § 21.223(b). He insists that *McCarthy* did not involve a fraudulent conveyance under TUFTA and did not deal with allegations that the shareholder transferred assets for unfair consideration (constructive fraud) or with intent to defraud creditors (actual fraud). TUFTA addresses fraudulent transfers to third parties in order to place the assets beyond the reach of creditors trying to collect their debts. Transfers that violate the statute can be made either without "reasonable equivalent value," which does not constitute actual fraud, or with intent to hinder or delay, which may constitute actual fraud under *McClellan*. In *McCarthy*, the defendant used a corporation as a front to borrow funds and order wallboard on credit so he could divert the funds to his personal use and benefit, i.e., conversion (taking the property of another without consent for the taker's own use and benefit), not a

fraudulent conveyance (transferring property owned by the debtor to a third party to avoid satisfying the claims of creditors). Ritz could not find a Texas case holding that any fraudulent conveyance, as opposed to conversion of assets, constitutes actual fraud.

Even if Husky is correct that actual fraud includes more than affirmative misrepresentations, even if the transfers can be construed as a fraudulent artifice or device, and even if Ritz has the requisite scienter, Ritz contends that Husky's § 523(a)(2) claim still fails as a matter of law because Chrysalis did not obtain the property by means of any fraudulent conduct, and the debt incurred by Chrysalis to Husky was the result of the sale of property, not of actual fraud.[22]

Moreover the statute also requires the creditor to prove a direct nexus between the debt for the money

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[22] Husky responds that it never argued that Chrysalis fraudulently obtained any property. It suggests that Ritz's error came from his assumption that Ritz's fraud occurred at the inception of the commercial debt owed by Chrysalis to Husky. The Bankruptcy Code broadly defines "debt" as any "right to payment," liquidated or unliquidated, disputed or undisputed, legal or equitable." 11 U.S.C. § 101(12) and § 101(5); *Johnson v. Home State Bank*, 501 U.S. 78, 83–84 and n. 5 (1991). In *McClellan* the original debt was not the one in dispute: "The debt at issue here is the debt that the sister incurred to McClellan by committing a fraud against him. Because it was an actual fraud, the debt that gave rise to it is not dischargeable." 271 F.3d at 895. The McClellan court further observed, "Stated differently, the brother gave his sister McClellan's security interest, McClellan's property, which means that she was taking property from —defrauding— McClellan directly." *Id.* Here the debt rose as a matter of law when Ritz prevented Husky from collecting from Chrysalis by draining the insolvent Chrysalis of $1.1 million it had remaining and transferring it to companies owned and controlled by Ritz and used as mere conduits to himself. *Id.*

property or services and the fraudulent activity, i.e., the actual fraud must have been part of the transaction which created the debt incurred to by the parts from Husky. *Field v. Mans*, 516 U.S. at 64 (barring discharge of debts "traceable to" fraud); *Nunnery v. Rountree* (In re Rountree), 478 F.3d 215, 219 (4th Cir. 2007) ("The plain language of [§ 523(a)(2)] ... requires the debtor to have obtained money, property, services, or credit through her fraud or use of false pretenses.... Congress excepted from discharge not simply any debt incurred as a result of fraud, but only debts in which the debtor used fraudulent means to obtain money, property, services, or credit."); *McCrory v. Spigel*, 260 F.3d 27, 32 (1st Cir. 2001) (although the transactions involved fraud, there was no proof of a direct link between the fraud and the debt). The sale of parts from Husky to Chrysalis was handled by Chrysalis's California sales representatives; Ritz had no part in it. Thus there was no nexus between the debt for the sale of parts and any fraud committed in connection with Ritz's transfers of the cash.

Ritz further argues that *McClellan* was wrongly decided for at least two reasons. First, before it was issued in 2000, a fraudulent conveyance, which was a matter of state statute, was never viewed as actual fraud. The Bankruptcy Code has statutes that address the avoidance and denial of discharge relating to fraudulent transfers. 11 U.S.C. §§ 548, 550, and 727. Ritz asserts that it was not likely that Congress viewed fraudulent conveyance as an element of nondischargeable fraud when the Bankruptcy Code already included statutes addressing the same subject. Second, *McClellan* in effect deletes the "for money, property or services ...

to the extent obtained by" clause out of the statute by providing an end run around the "obtained by" requirement; it helped courts to create a new debt for damages relating to the fraudulent transfer to a third party instead of a transfer of money, property or services from the creditor to the debtor. *McClellan*, 217 F.3d at 895. At the least the *McClellan* interpretation is strained; at worst it is judicial activism that should not be followed. Even if the Court finds the *McClellan* interpretation to be reasonable, Husky did not plead or try the case to collect damages for a fraudulent conveyance, Ritz argues, but only to collect the amount still due on the sale of the parts to Chrysalis.

Regarding Husky's claim under § 523(a)(6), Husky bore the burden to prove by a preponderance of evidence that Ritz acted willfully and maliciously. *Grogan v. Garner*, 498 U.S. 279, 286 (1991). A willful injury is "a deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury," and does not arise from recklessly or negligently inflicted injuries. *Kawaauhau v. Geiger*, 523 U.S. 57, 61 (1998). The statute addresses intentional torts that usually require the actor to intend the consequences of an act, not just the act itself. *Restatement (Second) of Torts § 8A*, cmt. a, p. 15 (1964). An injury by the debtor to another entity is willful and malicious if there is either an objective substantial certainty of harm or a subjective motive to cause harm. *In re Matter of Miller*, 156 F.3d 598, 601 (5th Cir. 1998), *cert. denied*, 526 U.S. 1016, 119 (1999). Ritz's job was confined to the financial aspects of Chrysalis and its efforts to find more funds to keep the business operational. Ritz only learned of the debt to Husky in mid January 2007, and then he

attempted to resolve the matter with Husky's representatives. Ritz submits two tables summarizing transfers in and out of Chrysalis and the income earned during this time period. # 10 at pp. 32, 33. Chrysalis paid employees at the California plant through May 2007 and continued ordering and paying for parts purchased from Dynalyst Manufacturing Corporation. He also signed the personal guarantee for approximately $133,000 for debts to Arrow Electronic. He maintains these facts do not support Husky's imposed image of a greedy, desperate owner trying to drain the company of its assets or an objective substantial certainty that Chrysalis would be unable to pay the debt it owed to Husky.

Ritz insists there is no evidence that he had a subjective motive to cause harm, i.e., that he subjectively intended for Chrysalis to purchase material from Husky with the intent that Husky not receive payment, especially because he had no part in the purchasing of those goods. Nor is there objective substantial certainty that the transfers would result in Husky's being deprived of payment. [23] From

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[23] Husky responds that the issue is not what Ritz subjectively intended during the material purchasing process, when the debt from Chrysalis to Husky was created, but what Ritz subjectively intended when he transferred $1.1 million of Chyrsalis's cash to other companies Ritz owned and/or controlled. A transfer is fraudulent if the debtor made the transfer without receiving a reasonable equivalent value in exchange and the debtor was insolvent at the time, as Judge Bohm found here under Tex Bus. Org.Code § 24.006(b). In other words, he found that Ritz subjectively intended to commit fraud.

As for objective substantial certainty that the transfers would result in Husky's being deprived of payment, as a matter of law transfers not supported by promissory notes

January 2006 to May 2007, more that $2.8 million were transferred in to Chrysalis to keep California manufacturing operations in business, the inbound transfers were loans, and they exceeded the outbound transfers by $924,000. Testimony by Nancy Finney showed that the transfers were intended to be loans, not capital contributions, and the company books also reflected that they were loans.

Husky's Reply (# 16)

Husky characterizes Ritz's arguments and reasoning as deeply flawed. First, relating to Husky's first point of error, Ritz's claim that the $1.1 million in transfers were loan payments is based on evidence outside the record, is contrary to Fifth Circuit authority, and was waived when he failed to raise that challenge in a cross appeal. The two tables he included to show that the funds going into Chrysalis were loan repayments are newly created and are based on at least two exhibits that were not admitted into evidence at trial. Ritz's Brief, p. 1, n. 1. Second, a district court may not set aside a bankruptcy court's findings of fact unless they are clearly erroneous." Fed. R. Bank. R. 8013. "As long as there are two permissible views of the evidence," the bankruptcy court's "choice between competing views" is not clearly erroneous. *Acosta*, 406 F.3d at 373. The bankruptcy judge's decision need only be

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reflecting interest rates and repayments are not "loans," but capital contributions. Bartley Tex. *Builders Hardware, Inc. v. Swor*, Adv. No. 07–03280, Civ. A. H–08–644, 2008 WL 5378068, at *2 (S.D. Tex. Dec. 24, 2008) ("The absence of either documentation of the loan or interest payments indicates capital rather than debt."), *rev'd on other grounds, In re Swor*, 347 Fed.Appx. 113, 116 (5th Cir. 2009).

"plausible in light of the record viewed as a whole." *Id.* Third, as a matter of law, undocumented "loans" with no repayment terms or interest rates, as is true of the transfers into Chrysalis here, are considered to be capital contributions, not loans. *Bartley Tex. Builders Hardware, Inc. v. Swor*, Adv. No. 07–03280, Civ. A. H–08–644, 2008 WL 5378068, at *2 (S.D. Tex. Dec. 24, 2008) ("The absence of either documentation of the loan or interest payments indicates capital rather than debt."), *rev'd on other grounds, In re Swor*, 347 Fed.Appx. 113, 116 (5th Cir. 2009) ("Although Mrs. Swor characterizes the funds they infused into the business as loans and the checks as repayments, the district court correctly treated money provided to the business as capital contributions: A loan is a capital contribution when payments correlate with the debtor's sense of his own financial situation and the debtor repays the money at his own discretion. The Swors had to show the court—an objective outsider—that they were debtors of their company, not just unwise investors. The Swors cannot prove debt. The absence of either documentation of the loan or interest payments indicates capital rather than debt. The Swors never had its company issue a promissory note for the loan nor did they enable the company to pay interest regularly to them. We agree with the district court that the bankruptcy court clearly erred in its conclusion that the Swors had loaned money to Swor's Glass."). *See also* 15A Charles Alan Wright, *et al.*, *Federal Practice & Procedure Juris.* § 3904 (2d ed., database updated Apr. 2014). The Court agrees.

Husky asserts that Ritz's biggest hurdle in claiming that the bankruptcy court erred in finding that Ritz's transfers were made "without Chrysalis receiving

reasonably equivalent value" is that Ritz did not raise this argument by cross-appeal. "Although an appellee may argue any ground available to support affirmance of a judgment, he may not argue for a ruling that would expand his legal rights under the judgment that was entered unless he raises it by cross-appeal." *Weaver v. Tex. Capital Bank, N.A.*, 660 F.3d 900, 905 (5th Cir. 2011), *cert. denied*, ——U.S. —— (2012); *see also Castellano v. Fragozo*, 352 F.3d 939, 960 (5th Cir. 2003) (en banc), *cert. denied*, 543 U.S. 808 (2004). Thus Ritz has waived any argument that Judge Bohm's findings that Ritz's transfers were fraudulent was erroneous.

Ritz's argument that *McClellan* was wrongly decided is not supported by any case. Instead, *McClellan* has been followed by numerous courts in several federal circuits. # 16 and nn. 6 & 7. As demonstrated in footnote 19 *supra*, Ritz's claim that *McClellan* stood for the proposition that fraudulent transfer is constructive fraud is incorrect. Moreover Husky insists that it pled and argued its fraudulent transfer claim at trial. Even if it had not, Ritz waived its complaint about the sufficiency of Husky's pleading by not challenging it in the bankruptcy court. In addition, Ritz's transfers of Chrysalis's money are "actual frauds" under TUFTA, Tex. Bus. & Com.Code §§ 24.005(a), 24.006. Husky points to the second sentence of its closing argument at trial in which Husky asserted a claim under TUFTA even though it did not use the acronym, but cited and read the entire text of Tex. Civ. Prac. & Rem.Code § 24.006(b)[24] and argued evidence of five badges of

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[24] Husky observes that this Court can take judicial notice of the fact that § 24.006(b) is part of TUFTA. Husky also notes that

fraud immediately afterward. # 12, $:11–9:3. Husky further points out that its complaint prays for relief as a result of Ritz's fraudulent transfers, details the specific amounts involved, names each transferee and the amount of the transfer it received, identifies the time period when the transfers were made, and specifies the relationship of each transferee to Ritz, all of which satisfy Rule 9(b). These fraudulent transfers make Ritz personally liable for Chrysalis's corporate debt to Husky under Tex. Bus. & Org.Code § 21.223(b). Under *McClellan* and its progeny, Husky maintains, Ritz's transfers are also "actual fraud" that warrants the bankruptcy court's denial of a discharge under § 523(a)(2)(A). *McClellan*, 217 F.3d at 893 ("'section 523(a)(2)(A) is not limited to "fraudulent misrepresentation"'"); *Mellon Bank, N.A. v. Vitanovich (In re Vitanovich)*, 259 B.R. 873, 877 (6th Cir. BAP 2001) ("[B]y distinguishing between 'a false representation' and "actual fraud," the statute makes clear that actual fraud is broader than misrepresentation.'", and quoting Collier on Bankruptcy that actual fraud encompasses "any deceit, trick or design involving direct and active operation of the mind, used to circumvent and cheat another").

Husky asserts that Ritz's debt to Husky is nondischargeable under § 523(a)(2) because Ritz obtained Husky's property by fraudulent transfer to *himself*. Husky argues that the debt at issue here is not the debt that Chrysalis owed Husky for goods sold and delivered to Chrysalis, but the debt which arose by operation of law from Ritz's fraudulent

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Ritz ultimately agreed that Husky asserted claims under TUFTA in the closing argument. Ritz's Brief, p. 15.

transfers to companies Ritz owned and controlled. In giving Chrysalis's cash to companies that Ritz owned and controlled, Ritz was taking property from, i.e., defrauding, Husky directly.

Even if Ritz's fraudulent transfers are not "actual frauds" for purposes of an exception to discharge in bankruptcy under § 523(a)(2), contends Husky, they are willful and malicious acts warranting an exception to discharge under § 523(a)(6).

In sum, Husky maintains that Judge Bohm erred in concluding that there was no "actual fraud" by Ritz. Actual fraud is not limited to misrepresentations at inception, but includes fraudulent transfers in violation of TUFTA. The bankruptcy court's other two errors of law, i.e., that exceptions to discharge in bankruptcy under § 523(a)(2)(A) and § 523(a)(6) do not apply here, arise from Judge Bohm's erroneous narrow definition of "actual fraud." The Court should find from the facts at trial that personal liability should be imposed on Ritz for Chrysalis's $163,999.48 contractual debt to Husky under Tex. Bus. Org.Code § 21.223(b) and should except Ritz's debt from discharge in bankruptcy under 11 U.S.C. §§ 523(a)(2)(A) and 523(a)(6).

Court's Decision

The Court addresses the first two points of error together: **(1) Did the bankruptcy court err when it ignored that fraudulent transfers pursuant to Tex. Bus. & Com.Code § 24.005 are "actual fraud" within the meaning of Tex. Bus. Org.Code § 21.223(b)? (2) Did the bankruptcy court err when it held that Husky could not prevail under 11 U.S.C. § 523(a)(2)(A) because Husky had failed to prove a fraudulent**

misrepresentation by Ritz that Husky relied upon?

The general rule of corporate exemption from liability in Texas is that the shareholder of a corporation

> may not be held liable to the corporation or its obligees with respect to ... any contractual obligation of the corporation or any matter relating to or arising from the obligation on the basis that the holder, beneficial owner, subscriber, or affiliate is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory[.]

Spring Street Partners–IV, LP v. Lam, 730 F.3d 427, 442 (5th Cir. 2013), quoting Tex. Bus. Org.Code § 21.223(a)(2). An exception is statutorily recognized "if the obligee demonstrates that the holder, beneficial owner, subscriber, or affiliate caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder, beneficial owner, subscriber, or affiliate." *Id.*, quoting *id.* § 21.223(b). Within the meaning of the Business Organizations Code for piercing the corporate veil regarding a contractual obligation, "actual fraud" according to § 2.21 "involves dishonesty of purpose or intent to deceive." *Id.* at 443, citing *Tryco Enterprises, Inc. v. Robinson*, 390 S.W.3d 497, 508 (Tex.App.—Houston [1st Dist.] 2012, rev. dism'd). Because of the limitations on the liability of a corporate shareholder, when a plaintiff seeks to hold an individual shareholder liable, he must "pierce the corporate veil." *Id.* According to Texas law, "'an assertion of veil

piercing or corporate disregard does not create a substantive cause of action[;] ... such theories are purely remedial and serve to expand the scope of potential sources of relief by extending to individual shareholders or other business entities what is otherwise only a corporate liability.'" *Id.*, *quoting In re JNS Aviation, LLC*, 376 B.R. 500, 521 (Bankr. N.D. Tex. 2007), *aff'd*, 395 Fed.Appx. 127, 128 (5th Cir. 2010).

In *Castleberry*, 721 S.W.2d at 271–73, the Texas Supreme Court held that a court can ignore the corporate structure "'when the corporate form has been used as part of a basically unfair device to achieve an inequitable result.'" In *Castleberry*, the court further concluded that the corporate structure could be ignored even if the plaintiff showed only constructive fraud,[25] rather than actual fraud. *Id.* Subsequently, however, the Legislature in § 21.223(a)(2) and (b) limited that rule to require a plaintiff to prove "actual fraud" if it related to "any contractual obligation of the corporation." *Id.* at 444.

Because there was a contractual obligation between Husky and Chrysalis, and because Judge Bohm determined that Husky has shown that Ritz caused Chrysalis to be used for the purpose of

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[25] "'[C]onstructive fraud is the breach of some legal or equitable duty which, irrespective of moral guilt, the law declares fraudulent because of its tendency to deceive others, to violate confidence, or to injure public interests.'" *Spring Street*, 730 F.3d at 443, *citing Castleberry*, 721 S.W.2d at 273, *citing Archer v. Griffith*, 390 S.W.2d 735, 740 (Tex. 1965). For constructive fraud a plaintiff does not have to prove fraud nor an intent to defraud, but need only show that recognizing the corporate entity would effect an inequitable result. *Id.*, *citing Castleberry*, 721 S.W.2d at 272–73.

perpetrating and did perpetrate an actual fraud on its creditors primarily for Ritz's direct personal benefit, i.e., he drained Chrysalis of funds and fraudulently transferred those funds to other entities under his control and/or ownership, section 21.233 applies here to impose liability on Ritz, individually. Nevertheless, Judge Bohm also held that "actual fraud" under Texas law requires a material misrepresentation that was false in order to induce action or inaction, and he found that there was no misrepresentation by the debtor under the facts of this case. Thus he ruled that Husky failed to satisfy an essential element for establishing actual fraud for either § 21.223 and § 523(a)(2)(A).

This Court has found cases that do not require a misrepresentation to pierce the corporate veil to satisfy "actual fraud" under § 21.223(b) and the standard of "dishonesty of purpose and intent to deceive" for actual fraud, including the Fifth Circuit in *Spring Street*, 730 F.3d at 442. "Courts may deduce fraudulent intent from all the facts and circumstances," and the "generally look at the totality of a shareholder's actions to determine whether [a corporate director" committed actual fraud. *Id.* at 443, 445 (finding actual fraud where the defendant created an LLC to which it transferred assets and allowed the company's charter to lapse after it was sued). The Fifth Circuit concluded that Spring Street could pierce the corporate veil of DKL & DTL on the basis of fraud and impose individual liability on its owners, Long Lam and En Lam:

> We need not resolve whether the standard is invariably that of constructive fraud where fraudulent transfers have occurred, because Spring Street has offered ample evidence to

> demonstrate Long Lam and En Lam's actual fraud here. Spring Street as summarized this evidence as follows: (1) they "formed an LLC ten days after their brother Douglas Lam received notice that his debts were being accelerated"; (2) they "paid no consideration for a 25% interest each in his assets"; (3) they "personally signed a paper transferring one of those assets to another family member for no consideration"; (4) they "failed to disclosse this fact for over a year while their entity was involved in [this] litigation"; (5) they "tried to evade company liability under TUFTA by allowing the company charter to lapse"; and (6) they "then tried to evade individual liability by claiming that the charter had been reinstated." Long Lam and En Lam, along with the other DKL & DTL members, acted for their direct personal benefit, they had no other interest to serve.

730 F.3d at 445.

In *Tryco Enterprises, Inc. v. Robinson*, 390 S.W.3d 497, 508, 510 (Tex.App.—Houston [1st Dist.] 2012, pet. dism'd) (For a plaintiff to pierce the corporate veil and impose liability under an alter ego theory of liability, the plaintiff must demonstrate "(1) that the persons or entities on whom he seeks to impose liability are alter egos of the debtor and (2) that the corporate fiction was used for an illegitimate purpose."), the court of appeals held that a corporation, Tryco Enterprises, was used by its officers as a means of defrauding Robinson by transferring assets of Tryco that were subject to Robinson's judgment lien in a suit against Tryco to Crown Staffing, which the officers had previously

incorporated, leaving Tryco without assets to pay that judgment. There was no representation involved.

Therefore the remaining issue for the first and second points of error is whether such fraudulent transfers under Tex. Bus. & Commerce Code § 24.005[26] would qualify as "actual fraud" within the meaning of Texas Business Organizations Code § 21.223(b). A transfer is fraudulent under § 24.005 "if the debtor made the transfer ... with actual intent to hinder, delay, or defraud any creditor of the debtor. *Id.*, at § 24.005(a)(1). Fraudulent intent, and thus fraudulent conduct, may be inferred from "circumstantial evidence and the surrounding circumstances of the transactions." *Kaye v. Lone Star Fund v. (U.S.) LP*, 453 B.R. 645, 671 (N.D. Tex. 2011).

"[I]n the context of piercing the corporate veil, actual fraud ['dishonesty of purpose or intent to deceive'] in not equivalent to the tort of fraud." *Latham v. Burgher*, 320 S.W.3d 602, 607 (Tex.App.—Dallas 2010). To prevail on a fraudulent conveyance claim under § 24.005, a trustee must prove that the debtor made the transfers in question "with actual intent to hinder, delay, or defraud any creditor of the debtor. He may do so by circumstantial evidence, which TUFTA identifies as "badges of fraud," some of which are codified in a nonexclusive list in § 24.005(b). *In re Soza*, 542 F.3d 1060, 1066 (5th Cir. 2008). If the trustee can show four or five "badges of fraud"[27] on the part of the debtor, he can establish

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[26] The purpose of TUFTA is "to prevent debtors from defrauding creditors by placing assets beyond their reach." *Challenger Gaming Solutions, Inc. v. Earp*, 402 S.W.3d 290, 293

[27] *See* footnote 12 of this Opinion and Order.

intent to commit actual fraud by the debtor. *Ingalls v. SMTC Corp. (In re SMTC Mfg. of Tex.)*, 421 B.R. 251, 199–300 (Bankr. W.D. Tex. 2009). Judge Bohm found the trustee had proven four badges of fraud by Ritz and therefore met the requirements for fraudulent transfer under § 24.005.

Nevertheless, Husky still cannot prevail. While the fraudulent transfer without a misrepresentation may qualify as actual fraud under § 21.223(b)(1) to pierce the corporate veil, it cannot meet the requirement under 11 U.S.C. § 523(a)(2)(A) to bar the discharge of the debt, which provides that a debtor may not be discharged from any debt for money to the extent that it was obtained by "false pretenses, a false representation or actual fraud." In *Field v. Mans*, 516 U.S. 59, 69 (1995), the United States Supreme Court observed that "'It is ... well established that "[w]here Congress uses terms that have accumulated settled meaning under ... the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms."'" It held *inter alia* that the terms "false pretenses, a false representation, or actual fraud" are to be given their ordinary common law meanings in 1978. It indicated, "Then, as now, the most widely accepted distillation of the common law of torts was the *Restatement (Second) of Torts* (1976), which should apply rather than a particular state's law. *Id.* at 70, n. 9. The Fifth Circuit accordingly, citing *Field*, has opined that the terms, "false pretenses," "false representation," and "actual fraud" in § 523(a)(2) are "terms of art ... [and] are common law terms." *AT & T Universal Card Services v. Mercer (In re Mercer)*, 246 F.3d 391, 402 (5th Cir. 2001). Nevertheless the

Restatement does not define "fraud," nor "actual fraud, but references only "fraudulent misrepresentation." *Id.* The *Restatement (Second) of Torts* § 525 (1976) defines fraudulent misrepresentation as follows:

> One who fraudulently makes a misrepresentation of fact, opinion, intention or law for the purpose of inducing another to act or to refrain from action in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation.

The Fifth Circuit has observed that it was unclear whether its earlier distinction among the three terms has survived *Field*, but decided it was not required in *Mercer* to address the question. *In re Mercer*, 246 F.3d at 394–95. In *General Electric Capital Corp. v. Acosta*, 406 F.3d 367, 372 (5th Cir. 2005), however, the Fifth Circuit identified the same elements for false pretenses, false representations and actual fraud.[28] Because the common law interpretation of § 523(a)(2)(A) requires a misrepresentation and there is no evidence here that Ritz made one, Husky's claim of nondischargeability under the statute fails.

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[28] Even if one assumed the Chrysalis promised to pay its debt to Husky in the future, Husky's claim under § 523(a)(2)(A) would still fail for lack of evidence of scienter. Chrysalis's promise to pay its debt to Husky in the future could be the basis of a nondischargeable debt under the actual fraud arm of § 523(a)(2)(A) if Husky had proved by a preponderance of the evidence that the debtor had no intention of fulfilling that promise at the time it was made. *In re Borschow*, 454 B.R. 374, 395 (Bkrtcy. W.D. Tex. 2011), *citing In re Roeder*, 61 B.R. 179, 181 (Bankr. W.D. Ky. 1986).

As for Husky's challenged reliance on *McClellan* v. *Cantrell*, 217 F.3d 890, 893 (7th Cir. 2000), contrary to Husky's argument, its broad interpretation of actual fraud under § 523(a)(2)(A) has not been accepted by everyone. Among appellate courts rejecting it is the First Circuit Court of Appeals. *See Palmacci v. Umpierrez*, 121 F.3d 781 (1997) (requiring false representation); *In re Spigel*, 260 F.3d 27, 32 (1st Cir. 2001). *See also Foley & Lardner v. Biondo (In re Biondo)*, 180 F.3d 126, 130 (4th Cir. 1999) (strictly examines misrepresentations); *Blacksmith Investments, LLC v. Woodford (In re Woodford)*, 403 B.R. 177, 186–87 (Bankr. D.Mass. 2009) (Feeney, J.) (*McClellan* reading was inconsistent with the Supreme Court's interpretation of actual fraud); *KMK Factoring, LLC v. McKnew* (In re McKnew), 270 B.R. 593, 618 n. 40 (Bankr. E.D. Va. 2001); *In re Kimmel*, 2006 WL 6810976, at *8 (9th Cir. BAP Cal. Dec. 29, 2006) ("Neither the Ninth Circuit nor this Panel has endorsed the approach taken to interpretation of § 523(a)(2)(A) in *McClellan* in any reported decisions," but "there is ample authority in this Circuit instructing that the provisions of the § 523(a)exceptions to discharge should be construed narrowly."), *citing Cal. Franchise Tax Bd. v. Jackson (In re Jackson)*, 184 F.3d 1046, 1051 (9th Cir. 1999). This Court has not found a decision from any court in the Fifth Circuit that has followed *McClellan*.

Therefore the Court agrees with Judge Bohm that since there is no representation involved in this Adversary Proceeding, Husky fails to prevail under § 523(a)(2)(A) to overturn the discharge of Chrysalis' debt to Husky.

(3) Did the bankruptcy court err when it held that Husky could not prevail under 11 U.S.C.

§ 523(a)(6) ("A discharge under 727 ... of this title does not discharge an individual debtor from any debt... for willful and malicious injury by the debtor to another entity or to the property of anotner entity") because Ritz's fraudulent transfers of Chrysalis's cash were not a willful or malicious injury to Husky?

Judge Bohm determined,

> The record is wholly devoid of any proof that the Debtor willfully and maliciously injured Husky or Husky's property. While Husky's complaint makes a glancing reference to 11 U.S.C. § 523(a)(6), that alone is not enough to preserve a claim under this provision—no exhibits were introduced, no testimony was adduced, and no briefing was done relating to § 523(a)(6) Husky provided goods to Chrysalis on an entirely unsecured basis.... Typically, complaints under § 523(a)(6) by creditors involved in a business transaction involve secured creditors who are seeking to prevent a discharge of a debt where the debtor has: (1) deliberately sold collateral out of trust and spent the sale proceeds; or (2) deliberately destroyed or damaged the collateral. *See, e.g., Friendly Fin. Serv. Mid–City, Inc. v. Modicue (In re Modicue)*, 926 F.2d 452 (5th Cir. 1991). This Court has found no case law where an unsecured creditor trade creditor *[sic]* has obtained a judgment for nondischargeability under § 523(a)(6) where the debtor simply failed to honor a contractual obligation to pay for the goods or services provided by that creditor. Accordingly, Husky may not prevail under 11 U.S.C. § 523(a)(6).

459 B.R. at 635. He noted, "'While an intentional breach of contract can be excepted from discharge under § 523(a)(6) when it is accompanied by malicious and willful tortious conduct, [Husky] ... failed to identify any tortious action by the [Debtor] that caused a willful and malicious injury.'" *Eagle Sindh, Inc. v. Desai (In re Desai)*, Adv. No. 07–04190, 2009 WL 2855735, at *6, 2009 Bankr. LEXIS 2609, at *19–20 (Bankr. E.D. Tex. Sept. 2, 2009). *Id.*, n. 11.

The Fifth Circuit has interpreted "willful" and "malicious" as one, with a single standard: "we hold that an injury is willful and malicious where there is either objective substantial certainty of harm or a subjective motive to cause harm." *Miller v. J.D. Abrams, Inc. (Matter of Miller)*, 156 F.3d 598, 606 (5th Cir. 1998).

"Secured creditors whose collateral was disposed of by the debtor often assert nondischargeability claims under § 523(a)(6)." 4 *Collier on Bankruptcy* ¶ 523.12(3) (16th ed. 2012). *See also In re Peckham*, 442 B.R. 62, 79 n. 7 (Bkrtcy. D.Mass. 2010) ("Litigation under section 523(a)(6) for willful and malicious injuries often arises in the context of conversion of collateral, resulting in courts' focusing on harm to creditors' economic interests."). Judge Bohm stated that he had "found no case law where an unsecured creditor ... has obtained a judgment for nondischargeability under § 523(a)(6) where the debtor has simply failed to honor a contractual obligation to pay for the goods or services provided by that creditor." 459 B.R. at 635. He emphasized that Husky failed to introduce any exhibits, testimony or briefing to support the 523(a)(6) dischargeability exception here, i.e., "rather than showing that Ritz deliberately sold collateral out of a trust or

deliberately destroyed or damaged collateral, Ritz merely failed to honor a contractual obligation to pay for goods or services provided by an unsecured trade creditor."

Not only did Husky fail to show by a preponderance of the evidence that Ritz acted willfully and maliciously, but this Court notes that as an unsecured creditor, Husky did not have a clearly valid claim, lien, right, interest or privilege to the monies transferred out of Chrysalis. A breach of contract suit that is an unsecured debt is dischargeable in bankruptcy. *In re Williams*, 466 B.R. 95, 106 (Bkrtcy. S.D. Tex. 2011).

Accordingly, for these reasons the Court AFFIRMS Judge Bohm's decision.

APPENDIX C

United States Bankruptcy Court
S.D. Texas
Houston Division

In re Daniel Lee RITZ, Jr., Debtor.
Husky International Electronics, Inc., Plaintiff,
v.
Daniel Lee Ritz, Jr., Defendant.

Bankruptcy No. 09-39895-H4-7.
Adversary No. 10-03156. Aug. 4, 2011.

MEMORANDUM OPINION REGARDING PLAINTIFF'S ORIGINAL COMPLAINT TO DENY DISCHARGEABILITY OF DEBT PURSUANT TO 11 U.S.C. § 523

[Adv. Docket No. 1]

JEFF BOHM, Bankruptcy Judge.

I. INTRODUCTION

This adversary proceeding concerns an individual debtor who authorized transfers of funds out of one corporation into the accounts of several other companies—all of which he controlled. As a result of these transfers, the one corporation was drained of all of its cash and, therefore, could not pay its creditors. One of these creditors has filed suit against the debtor, alleging that: (a) because of the debtor's actions, he has become personally liable for

the debt owed by the corporation; and (b) this debt is nondischargeable under 11 U.S.C. §§ 523(a)(2)(A), (a)(4) & (a)(6).[1] For the reasons set forth herein, this Court concludes that there is no debt to discharge because the plaintiff failed to establish any liability against the debtor. Therefore, the plaintiff cannot prevail under 11 U.S.C. §§ 523(a)(2)(A), (a)(4) & (a)(6).

II. STATUS OF THE MAIN CASE

Daniel Lee Ritz, Jr. (the Debtor or Ritz) filed his voluntary Chapter 7 petition on December 31, 2009. [Main Case, No. 09–39895, Docket No. 1]. The meeting of creditors was held on February 19, 2010. The case appeared to be routine with the exception of the timely filing of the pending adversary proceeding. Indeed, the Chapter 7 Trustee eventually represented that there were no assets available for distribution to pay claims; and, accordingly, on February 25, 2011, this Court signed a final decree closing the main case. [Main Case, No. 09–39895, Docket No. 34].[2] However, on June 2, 2011, the Trustee filed a Motion to Reopen the Chapter 7 Case by setting forth that the Trustee has received information that the Debtor had not disclosed all of his assets and that the case should be reopened. [Main Case, No. 09–39895, Docket No. 36]. On June 9, 2011, this Court signed the Order Granting this Motion to Reopen. [Main Case, No. 09–39895, Docket

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[1] Reference to any section (*i.e.*, §) refers to a section in 11 U.S.C., which is the United States Bankruptcy Code. Any reference herein to "the Code" refers to the United States Bankruptcy Code.

[2] The signing of the final decree with respect to the main case did not, however, resolve the pending adversary proceeding. The Court still had to hold the trial on this discrete dispute.

No. 37]. Accordingly, at this point, the Chapter 7 Trustee is conducting an investigation to determine whether there are, in fact, assets of sufficient value to make a distribution to creditors of this estate.

III. FINDINGS OF FACT[3]

1. On March 31, 2010, Husky International Electronics, Inc. (Husky) filed Plaintiff's Original Complaint to Deny Dischargeability of Debt Pursuant to 11 U.S.C. § 523 (the Complaint), which initiated this adversary proceeding. [Adv. Docket No. 1].
2. Prior to the filing of the Complaint and the filing of the bankruptcy petition, from 2003 to 2007, Husky sold and delivered goods to Chrysalis Manufacturing Corp. (Chrysalis), pursuant to a written contract. [Plaintiff's Ex. Nos. 1 & 3].
3. Chrysalis failed to pay for goods sold and delivered to Chrysalis by Husky in the amount of $163,999.38. [Plaintiff's Ex. No. 2].
4. At all relevant times, the Debtor was in financial control of Chrysalis.[4] Moreover, he was the director and owner of at least 30% of

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[3] These Findings of Fact are based on both the exhibits admitted at trial and the testimony that was adduced in open court. If there is no corresponding exhibit citation with a finding of fact, the finding of fact is nevertheless supported by testimony adduced at trial. Further, even if a finding of fact does have an exhibit citation, that does not preclude testimony adduced at trial from also supporting such a finding.

[4] It is undisputed that, for all intents and purposes, Chrysalis is the same entity as Altatron.

Chrysalis common stock. [Adv. Docket No. 1, p. 2–3, ¶ 6; Adv. Docket No. 8, p. 2, ¶ 6].

5. At all relevant times, Chrysalis was not paying its debts as they became due.

6. At all relevant times, the sum of Chrysalis' debts were greater than all of Chrysalis' assets at a fair valuation.

7 Between November 2006 and May 2007, the Debtor caused $677,622.00 of Chrysalis' funds to be transferred to ComCon Manufacturing Services, Inc., a/k/a VirTra Merger Corporation, without Chrysalis receiving reasonably equivalent value for the transfer. [Plaintiff's Ex. No. 5].

8. Between November 2006 and May 2007, the Debtor caused $121,831.00 of Chrysalis' funds to be transferred to CapNet Securities Corporation, without Chrysalis receiving reasonably equivalent value for the transfer. [Plaintiff's Ex. No. 5].

9. Between November 2006 and May 2007, the Debtor caused $52,600.00 of Chrysalis' funds to be transferred to CapNet Risk Management, Inc., without Chrysalis receiving reasonably equivalent value for the transfer. [Plaintiff's Ex. No. 5].

10. Between November 2006 and May 2007, the Debtor caused $172,100.00 of Chrysalis' funds to be transferred to Institutional Capital Management, Inc., and Institutional Insurance Management, Inc., without Chrysalis receiving reasonably equivalent value for the transfer. [Plaintiff's Ex. No. 5].

11. Between November 2006 and May 2007, the Debtor caused $99,386.90 of Chrysalis' funds to be transferred to Dynalyst Manufacturing Corporation, without Chrysalis receiving reasonably equivalent value for the transfer. [Plaintiff's Ex. No. 5].

12. Between November 2006 and May 2007, the Debtor caused $26,500.00 of Chrysalis' funds to be transferred to Clean Fuel International Corp., a/k/a Gulf Coast Fuels, Inc., without Chrysalis receiving reasonably equivalent value for the transfer.

13. Between November 2006 and May 2007, the Debtor caused $11,240.00 of Chrysalis' funds to be transferred to CapNet Advisors Incorporated, without Chrysalis receiving reasonably equivalent value for the transfer. [Plaintiff's Ex. No. 5]. During all of these transfers, Chrysalis was still operational.

14. At all relevant times, the Debtor owned: (1) 30% of Chrysalis; (2) 85% of CapNet Securities Corporation; (3) 100% of CapNet Risk Management, Inc.; (4) 100% of Institutional Insurance Management, Inc.; (5) 40% of Institutional Capital Management, Inc.; (6) 25% of Dynalyst Manufacturing Corporation; and (7) 20% of Clean Fuel International Corp., a/k/a Gulf Coast Fuels. [Adv. Docket No. 8, p. 4, ¶ 9(c)].

15. As a result of the Debtor's orchestration of the fund transfers out of Chrysalis' account, Husky suffered damages in the amount of $163,999.38—which represents the amount owed to Husky by Chrysalis for the goods

which Husky delivered to Chrysalis. [Plaintiff's Ex. No. 2].

16. No exhibits were introduced and no testimony was adduced indicating that the Debtor made any oral or written representations to Husky inducing Husky to enter into a contract with Chrysalis. The only communication that the Debtor ever had with Husky was a telephone conversation between Husky's founder and president, Nick Davis, and the Debtor **after** the parties had entered into a contract and Husky had already shipped product to Chrysalis.

IV. CREDIBILITY OF WITNESSES

A. Husky's Witnesses

1. *Daniel Lee Ritz, Jr.*

The Court finds that Ritz is not a credible witness. During his testimony at trial, he gave answers which directly contradicted answers he had previously given in discovery. These contradictory statements relate to material issues. For example, his answer to Interrogatory No. 8(i) contradicts his testimony at trial on a very important issue. Interrogatory No. 8(i) reads as follows: "[i]dentify (by name, address, and telephone number) every Person who caused any transfer of money to be made in any amount between November 2006 and May 2007 from Chrysalis to: (i) ComCon Manufacturing Services, Inc ... and state the exact Dates and amounts of each such transfer of money each such Person made to the forgoing." [Husky's Ex. No. 172]. The Debtor's answer was as follows: "Marlin Williford was the primary person who managed these accounts. Defendant did not

initiate nor authorize any of these transfers." [Plaintiff's Ex. No. 172].

The language immediately above reflects a Shermanesque statement by Ritz that he never initiated or authorized any transfers. Yet, at trial, under cross examination by Husky's counsel, Ritz unequivocally admitted that he did authorize such transfers. Moreover, he could not offer any reasonable explanation as to why his answers were blatantly contradictory. On the witness stand, he claimed that he interpreted the interrogatory to mean that Husky wanted to know whether Ritz personally transferred the funds—and Ritz testified that he did not. This explanation is weak because Ritz conceded that he authorized certain individuals to make transfers without the need for them to obtain his approval for each and every transfer. Thus, his explanation is disingenuous, if not downright misleading.

And there is plenty more. For example, at trial, Ritz testified that he disputes that Chrysalis owes any debt to Husky. Ritz then conceded he signed an affidavit on October 24, 2007 representing that Chrysalis did in fact owe a debt to Husky. [Husky's Ex. No. 167] ("I entered into good faith negotiations, on behalf of Defendant Chrysalis, to settle all claims, avoid litigation and obtain a reduction from Plaintiff for any debts Defendant Chrysalis may owe.... Unfortunately, anticipated funds to satisfy *that* debt were not received and Chrysalis was unable to make it's [sic] timely payment.") (emphasis added). He later testified that he believes the debt is a little over $100,000.00. So within a few minutes, Ritz went from completely disputing the debt, to representing that a debt is owed, to representing that the debt is

in a fairly specific amount. This shell game underscores his lack of credibility.

All in all, the record is replete with Ritz's contradictions on several very germane issues in this suit. Additionally, his frequent inability to recall certain information was not coincidental. His ability to recollect was selective.

Finally, Ritz frequently gave non-responsive answers to questions which were unambiguous. His evasiveness and obfuscation further undermines his credibility. For all of the reasons set forth above, this Court finds Ritz not to be a credible witness. The Court gives very little weight to his testimony.

2. *Nicolas C. Davis*

Nicolas C. Davis was the president of Husky. The Court finds that his testimony is very credible, and the Court gives substantial weight to this testimony.

3. *Nancy K. Finney*

Nancy K. Finney worked as a comptroller for Ritz-controlled companies for approximately four years. The Court finds that her testimony is very credible, and the Court gives substantial weight to this testimony. Of particular significance, she testified that Ritz made the decisions to transfer large sums of cash out of Chrysalis's operating account and into the accounts of other companies controlled by Ritz.

4. *James D. Rogers*

James D. Rogers (Rogers) was Vice–President of Corporate Finance of CapNet Securities Corporation for approximately 2.5 years. The Court finds that his testimony is very credible, and the Court gives substantial weight to this testimony. Of particular significance, he testified that Ritz ran all of the

operations of the various companies in which he had an interest. He also testified that he did not participate in, or have knowledge about, any transfers of funds from Chrysalis to other entities controlled by Ritz—which is contrary to the testimony given by Ritz. The Court believes that Rogers told the truth and that Ritz did not.

5. *Richard Hollan*

Richard Hollan (Hollan), at one time, owned shares of Institutional Capital Management, Inc.—which is an entity owned 40% by Ritz. The Court finds that his testimony is very credible, and the Court gives substantial weight to this testimony. Of particular significance, Hollan testified that he has known Ritz for approximately twenty-five years and does not have a high opinion of him. Indeed, he testified that Ritz is not trustworthy. Finally, he testified that he is familiar with Ritz's business practices, and that Ritz controls all of the flow of money relating to corporations which he controls.

B. The Debtor's Witnesses

1. *Heather Cheaney*

The Court finds Ms. Cheaney to be credible, but does not find her testimony to be significant on any important points. Therefore, the Court gives Ms. Cheaney's testimony little weight.

2. *Daniel Lee Ritz, Sr.*

While the Court finds Daniel Lee Ritz, Sr. to be a credible witness, the Court gives less weight to his testimony because it recognizes that many of his statements were—not unsurprisingly—aimed at helping his son's case.

3. *Craig Takacs*

The Court finds Mr. Takacs to be a bit evasive in his responses to the questions posed to him. Accordingly, the Court gives little weight to his testimony.

4. *L. Andrew Wells*

The Court does not find Mr. Wells to be a credible witness and, therefore, gives his testimony little weight.

5. *Marlin R. Williford*

The Court finds Mr. Williford to be direct and forthcoming in his testimony. Accordingly, the Court finds Mr. Williford to be a credible witness and gives his testimony significant weight. However, his testimony did not concern the transfers of cash that Ritz orchestrated out of Chrysalis's operating account into the accounts of other entities controlled by Ritz.

V. CONCLUSIONS OF LAW

A. Jurisdiction, Constitutional Authority to Enter a Final Judgment, and Venue.

The Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. §§ 1334(b) and 157(a). This particular dispute is a core proceeding pursuant to 28 U.S.C. §§ 157(b)(2)(A), (I), and (O).

The Supreme Court's recent decision in *Stern v. Marshall* recognized significant limitations on bankruptcy courts' authority. 564 U.S. —— (2011). The undersigned bankruptcy judge therefore provides analysis of his constitutional authority to enter a final judgment in this adversary proceeding.

Stern concerned a bankruptcy court's authority over a debtor's common-law counterclaim to a proof of

claim filed against the estate. The Supreme Court held that a bankruptcy court may not constitutionally enter a final judgment over a counterclaim that would not necessarily be resolved by the resolution of the proof of claim. *Id.* at 2618. The counterclaim did not constitute a "public rights" dispute. *Id.* at 2615. Although public rights disputes may be decided by non-Article III tribunals, public rights disputes must involve rights "integrally related to a particular federal government action." *Id.* at 2611–13. Entering a final judgment with respect to the counterclaim would be an impermissible exercise of the judicial power of the United States. *Id.* at 2615.

The broader applicability of the Court's decision remains unclear. Other types of disputes frequently decided by bankruptcy courts may also require adjudication by an Article III court. *Granfinanciera, S.A. v. Nordberg*, for example, held that the adjudication of a fraudulent transfer claim against a creditor who had not filed a proof of claim did not fall within the public rights exception. 492 U.S. 33, 54–55 (1989). Following *Stern*, it is unclear whether the adjudication of a fraudulent transfer claim against a creditor who *has* filed a proof of claim falls within the public rights exception. The Court's authority over matters involving state-law causes of action is particularly questionable.

The Court concludes, however, that it may exercise authority over essential bankruptcy matters under the "public rights" exception. Under *Thomas v. Union Carbide Agric. Prods. Co.*, a right closely integrated into a public regulatory scheme may be resolved by a non-Article III tribunal. 473 U.S. 568, 593 (1985). The Bankruptcy Code is a public scheme for restructuring debtor-creditor relations,

necessarily including "the exercise of exclusive jurisdiction over all of the debtor's property, the equitable distribution of that property among the debtor's creditors, and the ultimate discharge that gives the debtor a 'fresh start' by releasing him, her, or it from further liability for old debts." *Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 363–64 (2006); *see N. Pipeline Const. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 71 (1982) (plurality opinion) (noting in dicta that the restructuring of debtor-creditor relations "may well be a 'public right' "). *But see Stern*, 131 S.Ct. at *2614 n. 7 ("We noted [in *Granfinanciera*] that we did not mean to 'suggest that the restructuring of debtor-creditor relations is in fact a public right.'").

This suit involves a dispute over the Debtor's discharge. The right to a discharge is established by the Bankruptcy Code and is central to the public bankruptcy scheme. *See Katz*, 546 U.S. at 363–64, (including a discharge among the "[c]ritical features" of a bankruptcy proceeding). A debtor, upon surrendering his or her assets for distribution in a Chapter 7 case, is entitled to a discharge. *See Tenn. Student Assistance Corp. v. Hood*, 541 U.S. 440, 447, (2004) ("A bankruptcy court is able to provide the debtor a fresh start in this manner ... because the court's jurisdiction is premised on the debtor and his estate, and not on the creditors."). Determinations of whether a debtor meets the conditions for a discharge are integral to the bankruptcy scheme, and the Bankruptcy Court has the authority to make such determinations.

Similarly, the Bankruptcy Court has the authority to determine when the statutorily established right to a discharge does *not* apply. Unless a creditor proves

the applicability of an exception to discharge, the creditor is entitled to collect only against the bankruptcy estate. *Tower Credit, Inc. v. Gauthier (In re Gauthier)*, 349 Fed.Appx. 943, 945 (5th Cir. 2009) (per curiam) ("[T]he creditor claiming nondischargeability ... has the burden of proving, by a preponderance of the evidence, that the debt is exempt from discharge."). When a bankruptcy court determines the extent of a creditor's nondischargeable claim, the court simply decides that a particular creditor is entitled to something more than the creditor would otherwise get out of the bankruptcy bargain. Such determinations are inextricably tied to the bankruptcy scheme and involve the adjudication of rights created by the Bankruptcy Code. This case therefore falls within the Bankruptcy Court's authority, and the Bankruptcy Court's judgment is final.

Venue in the suit at bar is proper pursuant to 28 U.S.C. § 1409.

B. The Debtor is not liable to Husky pursuant to Texas Business Organizations Code § 21.223(b) and, therefore, Husky cannot prevail under 11 U.S.C. § 523(a)(2)(A).

An officer, director, or shareholder of a company — *i.e.*,— "may only be held liable for the corporation's breach of contract under traditional veil piercing laws." *Kwasneski v. Williams (In re Williams)*, Adv. No. 10–05077, 2011 WL 240466, at *3, 2011 Bankr. LEXIS 266, at *7 (Bankr. W.D. Tex. Jan. 24, 2011). Previously, Texas law allowed for the corporate veil to be pierced under three expansive categories: "(1) the corporation is the alter ego of its owners and/or shareholders; (2) the corporation is used for illegal

purposes; and (3) the corporation is used as a sham to perpetrate a fraud." *Rimade Ltd. v. Hubbard Enters. Inc*, 388 F.3d 138, 143 (5th Cir. 2004) (quoting *W. Horizontal Drilling, Inc. v. Jonnet Energy Corp.*, 11 F.3d 65, 67 (5th Cir. 1994)).

However, Section 21.223(b) of the Texas Business Organizations Code (TBOC) imposes a new requirement for a litigant seeking to pierce the corporate veil for breach of contract. Unquestionably, the debt that Husky alleges is owed to it is based upon Chrysalis' breach of contract. This new provision provides that the plaintiff must also establish that the defendant shareholder "caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder." Tex. Bus. Orgs. Code § 21.223(b) (West 2007); *see also Rimade*, 388 F.3d at 143; *Williams*, 2011 WL 240466, at *3, 2011 Bankr. LEXIS 266, at *8. Accordingly, for Husky to impose liability on the Debtor for the contractual debt which Chrysalis owes to Husky, Husky must prove that: (a) the Debtor's conduct amounts to actual fraud on Husky; and (b) the Debtor's conduct was primarily for his direct personal benefit. Tex. Bus. Org. Code § 21.223(b); *Rimade*, 388 F.3d at 143; *JNS Aviation, Inc. v. Nick Corp.*, 418 B.R. 898, 907 (N.D. Tex. 2009); *Williams*, 2011 WL 240466, at *3–4, 2011 Bankr. LEXIS 266, at *7–9.

Actual fraud under Texas law is defined as "the misrepresentation of a material fact with intention to induce action or inaction, reliance on the misrepresentation by a person who, as a result of such reliance, suffers injury." *Trs. of the N.W. Laundry & Dry Cleaners Health & Welfare Trust Fund v. Burzynski*, 27 F.3d 153, 157 (5th Cir. 1994)

(internal quotation marks and citation omitted). The elements of actual fraud in Texas are: (1) the defendant made a representation to the plaintiff; (2) the representation was material; (3) the representation was false; (4) when the defendant made the representation the defendant knew it was false or made the representation recklessly and without knowledge of its truth; (5) the defendant made the representation with the intent that the plaintiff act on it; (6) the plaintiff relied on the representation; and (7) the representation caused the plaintiff injury. *Shandong Yinguang Chem. Indus. Joint Stock Co. v. Potter*, 607 F.3d 1029, 1032–33 (5th Cir. 2010) (citing *Ernst & Young L.L.P. v. Pac. Mut. Life Ins. Co.*, 51 S.W.3d 573, 577 (Tex. 2001)).

The record is wholly devoid of any such representation made by the Debtor. Indeed, the record reflects that the only communication that the Debtor had with Husky was a telephone conversation between Husky's founder and president, Nick Davis, and the Debtor **after** Husky had already shipped product to Chrysalis. [Finding of Fact No. 16]. Thus, because the Debtor could not possibly have made a representation to Husky that Husky relied upon before shipping the product to Chrysalis, Husky cannot satisfy the most crucial element for establishing actual fraud. Further, the tests for fraud under section 22.223 of TBOC and the requirements of section 523(a)(2)(A) of the Code are virtually the same.[5] *See Bale v. Ryan (In re Ryan)*,

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[5] At trial, after Husky put on its case in chief, the Debtor made an oral motion for a directed verdict on all causes of action brought by Husky. This Court ruled that the Plaintiff could not go forward with its prosecution of § 523(a)(2)(A), for the Plaintiff was unable to prove that the Defendant committed actual fraud.

443 B.R. 395, 408 (Bankr. N.D. Tex. 2010). Accordingly, this Court concludes that Husky's common law fraud cause of action must fail and, therefore, Husky may not prevail under § 523(a)(2)(A).[6]

C. The Debtor does not owe a fiduciary duty to the Plaintiff and, therefore, Husky cannot prevail under 11 U.S.C. § 523(a)(4).

Husky contends that the Debtor breached a fiduciary duty to it and that damages flow from that breach. In the 1939 case of *Conway v. Bonner*, however, the Fifth Circuit held that directors of a corporation do not owe a fiduciary duty to creditors of the corporation "so long as [the corporation] continues to be a going concern, conducting its business in the ordinary way, without some positive act of insolvency, such as the filing of a bill to administer its assets...." 100 F.2d 786, 787 (5th Cir. 1939).

More recently, the Fifth Circuit has stated in dicta that "[o]fficers and directors that are aware that the corporation is insolvent, or within the 'zone of insolvency' as in this case, have expanded fiduciary duties to include the creditors of the corporation." *Carrieri v. Jobs.com, Inc.*, 393 F.3d 508, 534 n. 24

The Court denied the motion for directed verdict in all other respects.

[6] Husky's causes of action alleging equitable recovery in quantum meruit and breach of contract must also fail, as these causes of action are against Chrysalis, not Ritz in his individual capacity; the corporate form maintains Ritz's shield against any liability.

(5th Cir. 2004).[7] However, the *Carrieri* statement is not binding on this Court for two reasons: (1) the statement in *Carrieri* is dicta, and, as such, is not binding; and (2) even if *Carrieri* does contradict *Conway*, *Carrieri* has no precedential value because "[w]here two previous holdings or lines of precedent conflict, the earlier opinion controls and is the binding precedent in the circuit." *Floyd v. Hefner*, No. H–03–5693, 2006 WL 2844245, at *12 (S.D. Tex. Sept. 29, 2006) (concluding that the language in *Carrieri* is dicta because it "could have been deleted without seriously impairing the analytical foundations of the holding and, being peripheral, may not have received the full and careful consideration of the court that uttered it.") (quoting *Gochicoa v. Johnson*, 238 F.3d 278, 286 n.11 (5th Cir. 2000)); *Soc'y of Separationists, Inc. v. Herman*, 939 F.2d 1207, 1211 (5th Cir. 1991) (internal citations omitted). Accordingly, *Conway* is binding on this Court and *Carrieri* is not.

The case of *Floyd v. Hefner*, written by the Honorable Melinda Harmon, United States District Judge for the Southern District of Texas, thoroughly and extensively analyzes this very issue and reaches a conclusion which this Court is bound to follow—namely, that officers and directors do not owe a fiduciary duty to creditors when their corporation is in the zone of insolvency. *Floyd*, 2006 WL 2844245, at *10. Judge Harmon's analysis guides this Court's

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[7] Other courts have interpreted *Carrieri* to mean that when a corporation is within the zone of insolvency, creditors have the ability to bring a derivative suit for violation of fiduciary duties. *Comerica Bank v. Rajaball (In re Rajaball)*, 365 B.R. 702, 708 (Bankr. S.D. Tex. 2007).

conclusion[8] that only the trust fund doctrine enables creditors to sue a corporation's officers and directors. *Id.* at *18–22. Understandably, "to pursue a successful trust fund claim, one must prove that a corporation is a) insolvent and b) ceased to do business at the time of the challenged transaction." *Askanase v. Fatjo*, 130 F.3d 657, 671 (5th Cir. 1997) (citing *Fagan v. La Gloria*, 494 S.W.2d 624, 628 (Tex.Civ.App.-Houston [14th Dist.] 1973, no writ)). Here, like in *Floyd*, the trust fund doctrine is inapplicable. At the time of the subject transactions, Chrysalis was still operational. [Finding of Fact No. 13]. Accordingly, the Debtor owed no fiduciary duty to the Plaintiff.

Finally, the concept that officers and directors of a corporation do **not** hold a fiduciary duty to creditors of the corporation is further reinforced by the case of *Comerica Bank v. Rajaball*, 365 B.R. 702, 708 (Bankr. S.D. Tex. 2007). In that case, the Honorable Marvin Isgur, Chief United States Bankruptcy Judge for the Southern District of Texas, held that directors do not hold fiduciary duties directly to creditors; "rather, when a corporation is insolvent, creditors have the ability to enforce such duties which continue to exist as to the corporation." *Id.* (citing *Floyd*, 2006 WL 2844245, at *10). Stated differently, even when the corporation is insolvent, a creditor may not directly

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[8] District Judge Harmon held that *Conway* remains binding precedent in the Fifth Circuit. *Id.* at *11–16. This Court believes that it is bound not only by Fifth Circuit rulings, but also by the rulings of the District Court. *In re MPF Holding U.S. LLC*, 443 B.R. 736, 753 (Bankr. S.D. Tex. 2011). Because District Judge Harmon has held that *Conway* is binding precedent, the undersigned judge will apply *Conway* to the pending dispute in this Court.

bring a lawsuit against officers and directors for breach of fiduciary duty. Instead, a creditor is able to bring a derivative lawsuit on behalf of the corporation against the directors. *Id.* And, this is what the Husky should have done in this suit. Husky should have done the following: (a) brought a derivative lawsuit against the Debtor on behalf of Chrysalis;[9] and (b) collected on that debt pursuant to applicable law.[10] This, however, Husky did not do. Therefore, Husky is out of luck and may not prevail under § 523(a)(4).

D. Husky has failed to prove that the Debtor committed willful and malicious injury to Husky or to Husky's property and, therefore, Husky cannot prevail under 11 U.S.C. § 523(a)(6).

The record is wholly devoid of any proof that the Debtor willfully and maliciously injured Husky or Husky's property. While Husky's complaint makes a glancing reference to 11 U.S.C. § 523(a)(6), that alone is not enough to preserve a claim under this provision—no exhibits were introduced, no testimony was adduced, and no briefing was done relating to § 523(a)(6). *United States v. Dunkel*, 927 F.2d 955, 956 (7th Cir. 1991) (per curiam) ("A skeletal

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[9] For a thorough discussion of this issue, see *Rajabali*, 365 B.R. at 708.

[10] In the alternative, Husky could have sued Chrysalis in state court and sought to have a receiver appointed. Then, Husky could have convinced that receiver to file suit against the Debtor on behalf of the corporation. Alternatively, Husky could have sought to put Chrysalis into an involuntary Chapter 7, and then made demand upon the Chapter 7 trustee to sue the Debtor on behalf of the corporation, including seeking a judgment of nondischargeability.

'argument,' really nothing more than an assertion, does not preserve a claim. Especially not when the brief presents a passel of other arguments.... Judges are not like pigs, hunting for truffles buried in briefs." (citation omitted)). Moreover, given the nature of the transaction between Husky and Chrysalis, even if Husky's complaint and briefing had made more substantive references to § 523(a)(6), it is highly doubtful that a different result could follow. Husky provided goods to Chrysalis on an entirely unsecured basis. [Finding of Fact No. 16]. Typically, complaints brought under § 523(a)(6) by creditors involved in a business transaction involve secured creditors who are seeking to prevent a discharge of a debt where the debtor has: (1) deliberately sold collateral out of trust and spent the sale proceeds; or (2) deliberately destroyed or damaged the collateral. *See, e.g., Friendly Fin. Serv. Mid–City, Inc. v. Modicue (In re Modicue)*, 926 F.2d 452 (5th Cir. 1991). This Court has found no case law where an unsecured creditor trade creditor has obtained a judgment for nondischargeability under § 523(a)(6) where the debtor has simply failed to honor a contractual obligation to pay for the goods or services provided by that creditor.[11] Accordingly, Husky may not prevail under 11 U.S.C. § 523(a)(6).

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[11] Husky's breach of contract claim "fails, as a matter of law, to establish that [the Debtor] caused a 'willful and malicious injury' for purposes of § 523(a)(6). While an intentional breach of contract can be excepted from discharge under § 523(a)(6) when it is accompanied by malicious and willful tortious conduct, [Husky] ... failed to identify any tortious action by the [Debtor] that caused a willful and malicious injury." *Eagle Sindh, Inc. v. Desai (In re Desai)*, Adv. No. 07–04190, 2009 WL 2855735, at *6,

VI. CONCLUSION

This Court acknowledges that the Debtor drained substantial funds out of Chrysalis's operating account and funneled these funds to other entities controlled by the Debtor. Moreover, this Court has found that the Debtor is not a credible witness. So—this Court shares Husky's view that the Debtor is not an upstanding businessman who can be trusted. The Court is therefore sympathetic to Husky's request for relief. Nevertheless, the Texas Legislature, for better or worse, has set a high bar for plaintiffs seeking to pierce the corporate veil in order to impose individual liability. Indeed, just a few years ago, Husky may have prevailed in his action against the Debtor. But, the Texas Legislature has changed the statute, and now Husky, like any plaintiff, must prove actual fraud. Actual fraud, however, is difficult to prove, and the Legislature has made clear that actions to pierce the corporate veil will be few and far between.

A judgment consistent with this Memorandum Opinion will be entered on the docket simultaneously with the entry on the docket of this opinion.

2009 Bankr. LEXIS 2609, at *19–20 (Bankr. E.D. Tex. Sept. 2, 2009).

Supreme Court, U.S.
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NO. 15-145

In the
Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC.,

Petitioner,

v.

DANIEL LEE RITZ, JR.,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF IN OPPOSITION

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September 30, 2015

QUESTION PRESENTED

The Bankruptcy Code exempts from discharge "any debt ... for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by ... false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." 11 U.S.C. §523(a)(2)(A). The question presented is whether this provision applies when the debtor concededly made no misrepresentation that induced the creditor to turn over any money, property, services or credit, and instead is alleged only to have engaged in a fraudulent conveyance that aided a third party in evading that party's own preexisting debts to the creditor.

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INTRODUCTION

This case does not warrant this Court's review. Although the petition correctly identifies a circuit split on whether a misrepresentation is an element of "actual fraud" under section 523(a)(2)(A) of the Bankruptcy Code, that split has developed only in the past few months. In the 15 years prior, only a single Court of Appeals had ever had occasion to resolve that question. The question presented thus simply does not arise with sufficient frequency to warrant this Court's resolution.

Moreover, the decision below plainly got the answer to that question right. As this Court has recognized, the evident purpose of section 523(a)(2)(A) is to bar discharge of a debt that "follows a transfer of value or extension of credit induced by falsity or fraud." *Field v. Mans*, 516 U.S. 59, 66 (1995). Here, there is no allegation that the debtor induced the creditor to transfer any value or credit at all, let alone employed any fraud to do so. Instead, the only claim is that the debtor employed a fraudulent conveyance to help a third party avoid its own debt to the creditor. While such conduct certainly may, in some circumstances, render the recipient of a fraudulent conveyance liable for the debts of the party that made the transfer, it does not give rise to a debt that is nondischargeable under section 523(a)(2)(A). In all events, even if all three courts below were wrong about that, petitioner still would not be entitled to the relief it seeks, as there are several alternative grounds for affirming the conclusion that respondent does not owe petitioner any nondischargeable debt. Accordingly. the petition should be denied.

STATEMENT OF THE CASE

A. Statutory Background

"The Bankruptcy Code provides diverse courses overburdened debtors may pursue to gain discharge of their financial obligations, and thereby a 'fresh start.'" *Harris v. Viegelahn*, 135 S. Ct. 1829, 1835 (2015). For an individual debtor, the choice is typically between Chapter 7 and Chapter 13. A Chapter 7 bankruptcy "allows a debtor to make a clean break from his financial past, but at a steep price: prompt liquidation of the debtor's assets." *Id.* Although the debtor's debts are discharged entirely, subject to certain specified exceptions, the debtor's pre-petition assets are lost entirely as well. Chapter 13, on the other hand, is a "wholly voluntary alternative to Chapter 7" that "allows a debtor to retain his property if he proposes, and gains court confirmation of, a plan to repay his debts over a three-to-five year period." *Id.* Unlike under a Chapter 7 plan, "[p]ayments under a Chapter 13 plan are usually made from the debtor's 'future earnings or other future income.'" *Id.* (quoting 11 U.S.C. §1322(a)(1)). Accordingly, while Chapter 13 does not demand that the debtor give up all of his pre-petition assets, it also does not provide the same immediate "clean break" as Chapter 7; discharge instead comes only after the debtor has completed the plan for paying off his debts.

Certain debts are not dischargeable in a Chapter 7 or a Chapter 13 bankruptcy. As relevant here, in both contexts:

> (a) A discharge ... does not discharge an individual debtor from any debt—

> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by
>
> > (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.

11 U.S.C. §523(a)(2)(A). As this Court explained in the course of extensively considering that provision in *Field*, the basic purpose of section 523(a)(2)(A) is to bar discharge "when the debt follows a transfer of value or extension of credit induced by falsity or fraud," 516 U.S. at 66—in other words, when the debtor employed falsity or fraud to get the creditor to part with whatever it was that gave rise to the debt.

Consistent with that purpose, and with *Field*'s holding that section 523(a)(2)(A) applies only when the creditor "justifiabl[y] reli[ed]" on the debtor's fraud, *id.* at 76-77, courts for years proceeded on the understanding that a creditor may invoke section 523(a)(2)(A) only when the debtor made a misrepresentation that induced the creditor to part with the money, property, services, or credit for which the debt is owed. In 2000, however, the Seventh Circuit gave section 523(a)(2)(A) a much broader reading, allowing a creditor to invoke it to bar discharge of a debt that was not for anything obtained from the creditor *at all*, let alone obtained by any fraudulent conduct. *See McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000). Instead, the debtor in *McClellan* had become liable for a debt that her *brother* owed the creditor because she obtained money

from *him* with knowledge that he was transferring it to her to evade *his* debt. According to the Seventh Circuit, section 523(a)(2)(A) still applied even though it was undisputed that the debtor did not induce the creditor to part with any money, property, services, or credit at all, let alone make a misrepresentation to the creditor to induce it to do so.

The question of whether section 523(a)(2)(A) may be invoked in the absence of a misrepresentation that induced the creditor to part with money, property, services, or credit arose only sparingly in the wake of *McClellan*, and no other Court of Appeals resolved it for the next 15 years.

B. Proceedings Below

1. Factual Background

This case involves an individual bankruptcy under Chapter 7 and a section 523(a)(2)(A) claim similar to the one pressed in *McClellan*. At all times relevant, respondent was a director and partial owner of Chrysalis Manufacturing Corporation, a company that manufactured electronic circuit boards. Pet.App.38a, 80a-81a. Although respondent was not involved in the company's day-to-day management, he did have financial control of Chrysalis. Pet.App.2a, 80a. From 2003 until 2007, petitioner sold and delivered electronic device components to Chrysalis pursuant to a written contract. Pet.App.80a. It is undisputed that respondent had no involvement in Chrysalis's negotiation of, entry into, or execution of that contract; instead, the only contact respondent "ever had with Husky was a telephone conversation ... after the parties had entered into a contract and Husky had already shipped" the components to

Chrysalis. Pet.App.83a. Chrysalis eventually stopped paying its debts to petitioner as they came due, resulting in an unsecured $163,999.38 debt for goods that petitioner had delivered to Chrysalis pursuant to their contract. Pet.App.81a-83a. While that debt was owing, respondent caused Chrysalis to make several transfers of its assets to other entities that he owned or controlled. Pet.App.81a-82a. Chrysalis ultimately filed for liquidation pursuant to Chapter 7 in 2008. *See In re Chrysalis Mfg. Corp.*, No. 08-33793 (Bankr. S.D. Tex.).

In 2009, petitioner initiated a diversity action against Chrysalis and respondent in federal district court seeking to hold respondent personally liable for Chrysalis's debt pursuant to section 21.223(b) of the Texas Business Organization Code, which allows piercing of the corporate veil to reach a director who "caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder, beneficial owner, subscriber, or affiliate." Pet.App.39a. Petitioner alleged that respondent committed "actual fraud" under section 21.223(b) by causing Chrysalis to transfer its assets in an effort to evade paying its debt to petitioner. Pet.App.39a.[1]

A few months after petitioner brought that diversity action, respondent filed a Chapter 7 petition for bankruptcy. Petitioner responded by initiating

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[1] The claims for which petitioner sought to pierce Chrysalis's corporate veil are claims for breach of contract, common law fraud, recovery in quantum meruit, and breach of fiduciary duty. *See* Dkt. 1, Cmpl., *Husky Int'l Elecs. Inc. v. Ritz*, 4:09-cv-01532 (S.D. Tex. May 20, 2009).

this adversary proceeding in Bankruptcy Court, again alleging that respondent is personally liable under Texas law for Chrysalis's $163,999.38 debt, and seeking to prevent respondent from discharging that debt under three provisions of the Bankruptcy Code: (1) the "actual fraud" prong of section 523(a)(2)(A); (2) section 523(a)(4), which bars discharge of a debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny"; and (3) section 523(a)(6), which bars discharge of a debt "for willful and malicious injury by the debtor to another entity or to the property of another entity." 11 U.S.C. §523(a); *see* Pet.App.79a.

2. The Bankruptcy Court's Decision

Following a bench trial, the Bankruptcy Court concluded that petitioner "failed to establish any liability against" respondent under Texas law or that any of the exceptions to discharge that it invoked applies. Pet.App.79a.

As to the threshold state law question of whether respondent is liable for Chrysalis's debt at all, the court held that respondent did not cause Chrysalis to "perpetrate an actual fraud" on petitioner within the meaning of section 21.223(b) of the Texas Business Organization Code. Pet.App.91a-92a. Reviewing state and federal court decisions interpreting that provision, the court concluded that section 21.223(b) requires proof, *inter alia*, that the alleged fraudster made a material misrepresentation to the purported victim. Pet.App.92a. Because "[t]he record is wholly devoid of any such representation," the court concluded that petitioner could not establish that respondent is liable for Chrysalis's debt under Texas

law. Pet.App.92a. The court further concluded that the debt would not be exempted from discharge under section 523(a)(2)(A)'s "actual fraud" prong anyway because "the tests for fraud under section 22.223 ... and the requirements of section 523(a)(2)(A) ... are virtually the same." Pet.App.92a.

The court also concluded that petitioner could not establish an exception to discharge under section 523(a)(4) or section 523(a)(6). As to the former, the court found that respondent "owed no fiduciary duty to" petitioner. Pet.App.95a. As to the latter, although the court agreed with petitioner that the transfers respondent caused Chrysalis to make were not made in exchange for "reasonably equivalent value," Pet.App.81a, it found "[t]he record ... wholly devoid of any proof that [Ritz] willfully and maliciously injured Husky or Husky's property" by making those transfers. Pet.App.96a.

3. The District Court's Decision

Petitioner appealed the Bankruptcy Court's rulings under Texas law and sections 523(a)(2)(A) and 523(a)(6) of the Bankruptcy Code, and the District Court affirmed the Bankruptcy Court's decision. Although the District Court disagreed with the Bankruptcy Court's conclusion that a misrepresentation is an element of "actual fraud" under section 21.223(b) of the Texas Code, it agreed with the Bankruptcy Court that a misrepresentation is an element of "actual fraud" under section 523(a)(2)(A) of the Bankruptcy Code. Pet.App.72a. In reaching that conclusion, the court followed this Court's instruction in *Field* that section 523(a)(2)(A) should be interpreted in accordance with the common

law as understood when Congress enacted the modern Bankruptcy Code in 1978. Pet.App.72a. "Because the common law interpretation of §523(a)(2)(A) requires a misrepresentation and there is no evidence here that Ritz made one," the court concluded that "Husky's claim of nondischargeability under the statute fails." Pet.App.73a.

As to petitioner's alternative claim that the debt is nondischargeable under section 523(a)(6), the District Court agreed with the Bankruptcy Court that "'[t]he record is wholly devoid of any proof" that respondent "acted willfully and maliciously," Pet.App.75a (quoting Pet.App.96a)—*i.e.*, that he acted with "'either objective substantial certainty of harm or a subjective motive to cause harm,'" Pet.App.76a (quoting *Miller v. J.D. Abrams, Inc.*, 156 F.3d 598, 606 (5th Cir. 1998)).

4. The Court of Appeals' Decision

Petitioner appealed again, and the Court of Appeals unanimously affirmed. Like the District Court and the Bankruptcy Court before it, the Court of Appeals concluded that a creditor cannot establish "actual fraud" under section 523(a)(2)(A) when, as here, "the debtor made no false representation to the creditor" to induce it to turn over any money, property, services, or credit. Pet.App.8a.

"Guided by Supreme Court and Fifth Circuit precedent," the court began by acknowledging that this Court's decision in "*Field* made clear that the meaning of 'actual fraud' depends on the 1978 common law meaning of the term." Pet.App.7a, 12a. Reasoning that petitioner "has pointed to no authority. and we are not aware of any, suggesting

that the common law meaning of 'actual fraud' at that time encompassed fraudulent transfers" in which the debtor made no misrepresentation that induced the creditor to turn over money, property, services, or credit, the court concluded that section 523(a)(2)(A) does not reach such transfers. Pet.App.12a. Although the court acknowledged the Seventh Circuit's contrary conclusion in *McClellan* that any "actually fraudulent conveyances—i.e., conveyances through which the debtor *intends* to hinder the creditor—constitute 'actual fraud' under Section 523(a)(2)(A)," it found *McClellan* unpersuasive and "in tension with ... *Field*." Pet.App.8a, 9a.

In light of its conclusion that petitioner could not establish nondischargeability under section 523(a)(2)(A), the Court of Appeals saw no need to address the question of Texas law that divided the courts below. Pet.App.6a. The court also declined to address respondent's alternative arguments that any debt he owes to petitioner is not a debt for money, property, services, or credit "obtained by" fraud, 11 U.S.C. §523(a)(2)(A); that the relevant transfers were not made with intent to deceive petitioner; and that the relevant transfers actually were for reasonably equivalent value. Pet.App.7a, 3a & n.2.[2]

The Court of Appeals also affirmed the District Court's holding that the debt is not nondischargeable

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[2] At trial, respondent presented evidence that the transfers were made to repay those entities for loans that they had made to Chrysalis, and that the funds flowing into Chrysalis always exceeded the funds flowing out. *See, e.g.*, Appellee's Br. 57-59, 5th Cir. No. 14-20526, (Dec. 16, 2014) (ECF No. 00512872798).

under section 523(a)(6). Like both courts below, the Court of Appeals found "scant evidence in the record indicating either that Ritz made the[] transfers with the intent to harm Husky, or that harm to Husky was substantially certain due to Ritz's actions." Pet.App.18a. Accordingly, it agreed that petitioner failed to meet its "burden to prove" that respondent owes petitioner any debt "for willful and malicious injury by the debtor to another entity or to the property of another entity." 11 U.S.C. §523(a)(6).

REASONS FOR DENYING THE PETITION

This petition does not warrant this Court's consideration. Although petitioner correctly identifies a circuit split over whether "actual fraud" under section 523(a)(2)(A) requires a misrepresentation to the creditor, that narrow 2-1 division is the product of the first two Court of Appeals decisions to address that question in the past 15 years. The infrequency with which the question has arisen in the Courts of Appeals over the past two decades is unsurprising, as most frauds do involve a misrepresentation, rendering the question whether section 523(a)(2)(A) requires one of little practical importance. And that question is of even less importance given that the Bankruptcy Code contains provisions that speak much more directly both to situations in which a debtor has used a fraudulent conveyance to avoid his own debts (which is *not* what is alleged to have happened here) and situations in which, like this one, the debtor is alleged (albeit not actually proven) to have been the knowing recipient of a fraudulent conveyance with the intention of aiding a third party in evading that third party's debts.

To be sure, petitioner could not avail itself of those provisions here. But that is because, contrary to its repeated suggestions, petitioner did not actually prove that respondent engaged in "a deliberate fraudulent-transfer-scheme with intent to cheat a creditor." Pet.8. It instead at most proved only that respondent caused a third party to make transfers for less than reasonably equivalent value, which *no* court considers sufficient to constitute "actual fraud" under section 523(a)(2)(A). Yet it is *only* in a Chapter 7 case with that kind of evidentiary deficiency on the intent question that a creditor would need to try to resort to section 523(a)(2)(A) rather than just using section 523(a)(6). Accordingly, in the only circumstance in which the question presented actually matters in a Chapter 7 case, there is no circuit split to resolve.

That said, if the Court is inclined to resolve that question, it should do so in this Chapter 7 case, rather than in the Chapter 13 context that the pending petition out of the First Circuit's recent decision on this question presents, or at least should do so in both cases rather than just that Chapter 13 case. Although the question arises infrequently in either context, it arises even less frequently in the Chapter 13 context, and its resolution may turn at least in part on interpretation of provisions that (unlike 523(a)(2)(A)) apply only in the Chapter 7 context. Accordingly, while there is no need for the Court to resolve the question presented at all at this time, should the Court decide to do so, it should grant either this petition alone or this petition in combination with the *In re Lawson* petition, so that the interests of the Chapter 7 debtors who are more likely to be affected by resolution of the question are fully represented.

I. The Question Presented Does Not Arise With Sufficient Frequency To Warrant This Court's Review.

The petition correctly identifies a division among the Courts of Appeals on the question presented, but it is a shallow split that does not warrant this Court's review at this time. When the Fifth Circuit issued the decision below, only one other Court of Appeals had decided whether section 523(a)(2)(A) bars discharge of a debt that arises from a fraudulent conveyance in which the debtor made no misrepresentation that induced the creditor to part with any property, money, services, or credit. *See McClellan*, 217 F.3d at 894. Petitioner identifies only a handful of Bankruptcy or District Court cases in which that issue was resolved in the 15 years following. *See* Pet. 14-15 nn.2 & 3. And it was only in the past four months that the Fifth Circuit became the first Court of Appeals to reject the Seventh Circuit's position, and the First Circuit the first to adopt it. *See In re Lawson*, 791 F.3d 214 (1st Cir. 2015), petition for cert. filed, No. 15-113 (July 27, 2015) (response requested Sept. 15, 2015).

Petitioner attempts to explain away the dearth of Court of Appeals cases resolving the question presented as the product of an emphasis on settlement in bankruptcy, Pet.15, but the more likely explanation is that the issue simply does not arise with any real frequency. And it is not hard to see why. As the Seventh Circuit pointed out in *McClellan*, "[m]ost frauds do involve misrepresentation," *McClellan*, 217 F.3d at 893, rendering the question whether section 523(a)(2)(A) applies to a fraud that lacks one academic. Moreover, as Judge Ripple explained in his

skeptical concurrence in *McClellan*, the rare fraud that does *not* involve a misrepresentation likely involves facts sufficient to satisfy section 523(a)(6)'s bar on discharge of debts "for willful and malicious injury by the debtor to another entity or the property of another entity," 11 U.S.C. §523(a)(6). *See McClellan*, 217 F.3d at 896 (Ripple, J., concurring). Indeed, Judge Ripple found that provision the "far more direct avenue for dealing with a situation such as the one [the court] ha[d] before" it, *id.*, and the majority did not disagree that it may well have covered the allegations at hand, *see id.*

To the extent petitioner's concern is with Chapter 7 debtors who employ fraudulent conveyances to evade paying *their own* debts—an entirely different scenario from what is alleged to have happened here—the Bankruptcy Code already covers that scenario as well. Section 727(a)(2)(A) provides an absolute bar to discharge for a Chapter 7 debtor who, "with intent to hinder, delay, or defraud a creditor ... has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed ... property of the debtor, within one year before the date of the filing of the petition." 11 U.S.C. §727(a)(2)(A). Petitioner presumably did not invoke that provision here because respondent is not alleged to have employed fraudulent transfers to evade his *own* debts. He is alleged to have employed fraudulent conveyances to aid *Chrysalis* in evading *Chrysalis*'s debts—conduct that (at least if undertaken with the requisite intent) fits much more comfortably into the category of "willful and malicious injury by the debtor to another entity or the property of another entity," 11 U.S.C. §523(a)(6), than

employing "actual fraud" to "obtain[]" money, property, services, or credit from that entity, *id.* §523(a)(2)(A).

To be sure, petitioner failed to prove that section 523(a)(6) bars discharge in this case. But that is not because that provision cannot reach "a deliberate fraudulent transfer-scheme with intent to cheat a creditor." Pet.8. It is because, notwithstanding petitioner's repeated suggestions otherwise, the courts below did not find that respondent engaged in such a scheme. While the Bankruptcy Court found that respondent caused Chrysalis to make transfers for which it did not receive "reasonably equivalent value," Pet.App.81a, all courts agreed that petitioner presented virtually no evidence to support its assertion that respondent "made the[] transfers *with the intent to harm*" petitioner. Pet.App.18a (emphasis added).[3] And *no* court thinks that making transfers for less than "reasonably equivalent value" constitutes

---

[3] While the District Court did suggest that the evidence was sufficient to demonstrate "intent to commit actual fraud" under Texas law, the court did so based only on the circumstantial evidence that the state's "badges of fraud" provision allows a court to take into consideration. Pet.App.71a-72a. When it came to examining respondent's intent under section 523(a)(6), the District Court agreed with the Bankruptcy Court that petitioner failed to prove that respondent caused Chrysalis to make the transfers with "'a subjective motive to cause harm'" to petitioner. Pet.App.76a. Although the Fifth Circuit had no occasion to resolve the intent question under Texas law, it too found when resolving the intent question under section 523(a)(6) that petitioner failed to prove that respondent "made the[] transfers with intent to harm" petitioner, Pet.App.18a—*i.e.*, with the "intent to cheat a creditor" that petitioner repeatedly attempts to ascribe to him.

"actual fraud" under section 523(a)(2)(A). To the contrary, the Seventh and the First Circuits both expressly distinguished "constructive" fraud—*i.e.*, where "the only evidence of [fraud] is the inadequacy of the consideration"—from "actual" fraud—*i.e.*, where "the debtor intended by the transfer to hinder his creditors"—and interpreted section 523(a)(2)(A) to reach only the latter. *McClellan*, 217 F.3d at 894; *see also In re Lawson*, 791 F.3d at 220 ("our holding is limited to cases of *actual*, as opposed to merely constructive, fraud").

While that means that this case does not actually present the question that petitioner has posed, it also underscores why there is no need to resolve that question at all. Precisely because section 523(a)(6) is available when a Chapter 7 debtor really has engaged in a fraudulent transfer scheme with intent to cheat the transferee's creditor, it is *only* the rare case in which the creditor cannot prove that intent that it would need to try to resort to section 523(a)(2)(A). But, again, *no* court thinks that section 523(a)(2)(A) reaches a fraudulent transfer scheme in which the debtor did not act with intent to injure the creditor. Accordingly, on the only question of any practical consequence in the Chapter 7 context, there is no circuit split at all.

Of course, neither section 523(a)(6) nor section 727(a)(2)(A) applies in Chapter 13 proceedings. Accordingly, if there really were a large number of debtors engaging in frauds that involve no material misrepresentation to the creditor, then one would expect to see a disproportionately high number of Chapter 13 cases involving the question presented. In

fact, it is just the opposite; the question has arisen with even less frequency in the Chapter 13 context than the Chapter 7 context. Indeed, of the various Bankruptcy Court cases petitioner cites, only two (plus *In re Lawson*) are Chapter 13 cases. *See* Pet.14-15 nn.2 & 3. That is just further confirmation that the Seventh Circuit was correct when it observed that "[m]ost frauds do involve misrepresentation," *McClellan*, 217 F.3d at 893, making whether section 523(a)(2)(A) applies in the absence of a misrepresentation a question of minimal practical importance that does not warrant this Court's review.

II. The Decision Below Is Correct.

This Court's review also is unwarranted because the decision below is correct, as were the two decisions below it that the Fifth Circuit affirmed. Under a straightforward application of the same statutory construction tools that this Court applied in *Field*, section 523(a)(2)(A) plainly does not bar discharge of a debt that is not the product of a misrepresentation that induced the creditor to part with money, property, services, or credit.

1. Section 523(a)(2)(A) renders nondischargeable:

> (a) ... any debt—
>
> > (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by
> >
> > > (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.

11 U.S.C. §523(a)(2)(A). As this Court has explained, the term "actual fraud" is a "common-law term" that "carr[ies] the acquired meaning of [a] term[] of art." *Field*, 516 U.S. at 69. Accordingly, to determine the elements of "actual fraud" under section 523(a)(2)(A), courts must "look to the concept of 'actual fraud' as it was understood" when section 523(a)(2)(A) was enacted in 1978, and to the "elements that the common law has defined [that concept] to include." *Id.* at 69-70.

To answer that very same question in *Field*, this Court looked principally to sections 537 and 540 of the Restatement (Second) of Torts (1976), "the most widely accepted distillation of the common law of torts" in 1978. *Id.* at 70. Those sections require a misrepresentation upon which the victim justifiably relied to its detriment. *See* Restatement (Second) of Torts (1976) §§537, 540. So, too, does section 871, on which the First Circuit heavily relied in *In re Lawson*. *See id.* §871 cmt. (e) ("The actor's conduct is fraudulent if he intentionally causes another to act or refrain from acting by means of intentionally false or misleading conduct or by his intentional concealment of facts or by his intentional failure to disclose a fact that he has a duty to reveal to the other."). To be sure, as section 871 reflects, the term "misrepresentation" is a broad one that encompasses "not only words spoken or written but also any other conduct that amounts to an assertion not in accordance with the truth." *Id.* §525 cmt. (b). But the irreducible minimum of "actual fraud" at common law is some sort of false statement or conduct on which the victim relied.

That proposition should hardly be controversial. One of the core distinctions between actual fraud and other torts is that actual fraud injures the victim *by inducing reliance*. *See, e.g.*, Black's Law Dictionary (10th ed. 2015) ("actual fraud: A concealment or false representation through an intentional or reckless statement or conduct *that injures another who relies on it in acting* (emphasis added)); Restatement (Third) of Torts: Liability for Economic Harm §9 Tentative Draft No. 2 (2014) (defining "fraud" as "mak[ing] a material misrepresentation of fact, opinion, intention, or law, *for the purpose of inducing another to act or refrain from acting*" (emphasis added)). Actual fraud thus, by definition, must involve some statement or conduct on which the victim could have relied in the first place. If there is no such misrepresentation, then there can be no reliance. And if there is no reliance, then there can be no actual fraud. Accordingly, when Congress incorporated the common-law term "actual fraud" into section 523(a)(2)(A), it also incorporated the settled understanding that actual fraud requires some misrepresentation on which the creditor relied.

2. That conclusion is confirmed by the surrounding statutory text. Section 523(a)(2)(A) bars discharge of any debt "*for* money, property, services, or an extension, renewal, or refinancing of credit, *to the extent obtained by* ... actual fraud." 11 U.S.C. §523(a)(2)(A) (emphasis added). The italicized language is critical, first, because, as this Court recognized in *Field*, "some degree of reliance is required to satisfy the element of causation inherent in the phrase 'obtained by.'" *Field*, 516 U.S. at 66. Indeed, there would have been no need for this Court to decide "what, if any, level of justification a creditor

needs to show above mere reliance in fact in order to exempt the debt from discharge under" the "actual fraud" prong of section 523(a)(2)(A) if the statute could apply in the absence of any reliance at all. *Field*, 516 U.S. at 66; *see also id.* at 70 & n.8 (confirming that Court was interpreting "actual fraud" prong). By using language that requires the creditor to have relied on the debtor's fraudulent statement or conduct, Congress confirmed its understanding that actual fraud requires some misrepresentation on which the creditor could have relied in the first place.

Moreover, "[t]he language 'obtained by' clearly indicates that ... the debtor committed a fraudulent act *to induce the creditor to part with his money or property*." *McClellan*, 217 F.3d at 896 (Ripple, J., concurring) (emphasis added). Indeed, the whole point of section 523(a)(2)(A) is to bar discharge "when the debt follows a transfer of value or extension of credit induced by falsity or fraud," *Field*, 516 U.S. at 66—in other words, when the debt is *for* money, property, services, or credit with which the debtor *induced the creditor* to part. That "causal connection between the misrepresentation and the transfer of value or extension of credit" by the creditor is the very heart of section 523(a)(2)(A). *Id.* at 67

That makes section 523(a)(2)(A) an incredibly poor fit for the type of fraudulent conveyance alleged here. Not only is it undisputed that respondent made no misrepresentation that induced petitioner to part with any money, property, services, or credit; it is undisputed that respondent obtained no money, property, services, or credit from petitioner *at all*. Instead, the only things of value with which petitioner

parted are the goods that it provided to *Chrysalis*—goods provided pursuant to a contract between those two parties that respondent concededly played no role in procuring. And that fact pattern is hardly unique to this case. The debtor in *In re Lawson* was alleged to have accepted fraudulent conveyances from her father to help him evade a debt that he already owed the creditor, wholly independent of any actions on her part. *See In re Lawson*, 791 F.3d at 216. Likewise, in *McClellan*, the debtor was alleged to have accepted fraudulent conveyances from her brother to help him evade a debt that he already owed the creditor, again wholly independent of any actions on her part. *See McClellan*, 217 F.3d at 892.

What is utterly lacking in each of those scenarios is any effort to "*induce the creditor* to part with his money or property." *McClellan*, 217 F.3d at 896 (Ripple, J., concurring). Instead, the only fraudulent conveyance alleged is one that did not involve the creditor at all, let alone any of his money or property. The Seventh Circuit attempted to get around that glaring flaw in its construction of section 523(a)(2)(A) by reasoning that "the statute does not require that the transferor *be the victim* of the fraud, but only that money, property, or services be obtained by fraud." *Id.* at 895 (emphasis added). But that flies in the face of this Court's decision in *Field*, which interpreted section 523(a)(2)(A) as applying only "when the debt follows a transfer of value or extension of credit induced by falsity or fraud." *Field*, 516 U.S. at 66. While receiving a fraudulent conveyance to help a third party avoid a debt that follows a transfer induced something else entirely certainly may, in the right circumstances, suffice to render the recipient liable for

the underlying debt, it does not create a debt "for money, property, services, or an extension, renewal, or refinancing of credit ... obtained by ... actual fraud." 11 U.S.C. §523(a)(2)(A).

3. Of course, none of that is to suggest that the Bankruptcy Code has nothing to say about debtors who use fraudulent conveyances to evade creditors. What it has to say about them just isn't found in section 523(a)(2)(A). First, petitioner's extensive reliance on treatises and cases dealing with debtors who conceal their *own* assets to avoid paying their *own* debts is entirely misplaced. *See* Pet.16-18. Not only is that manifestly not what this case is about; it is also something that the Bankruptcy Code already addresses in multiple ways. As the very sources on which petitioner relies confirm, when a debtor has fraudulently transferred *his own* assets with intent to evade *his own* creditors, the transfer typically may be invalidated and the assets returned to the estate for the creditors' benefit. *See, e.g.*, 11 U.S.C. §§548-52. Moreover, as explained, section 727(a)(2)(A) provides an absolute bar to discharge for a Chapter 7 debtor who, "with intent to hinder, delay, or defraud a creditor ... has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed ... property of the debtor, within one year before the date of the filing of the petition." 11 U.S.C. §727(a)(2)(A).

Petitioner complains that section 727(a)(2)(A) may not apply "where the debtor only *received* a fraudulent transfer" from some *other* debtor, with the intent to evade *that* debtor's creditors, rather than

making a fraudulent transfer with the intent to evade his own. Pet.20. But there is no need to stretch section 523(a)(2)(A) to reach that situation either, as that, too, is something that the Bankruptcy Code already addresses through section 523(a)(6). *See supra* pp.12-14. Unlike section 523(a)(2), section 523(a)(6) is not confined to "debt[s] ... for money, property, services, or an extension, renewal, or refinancing of credit ... *obtained by*" the tortious conduct; it instead applies to "any debt ... for willful and malicious injury by the debtor," 11 U.S.C. §523(a)(6), a standard that the courts here described as satisfied by proof of "either an objective substantial certainty of harm or a subjective motive to cause harm." Pet.App.17a, 76a. Section 523(a)(6) thus supplies a "far more direct avenue for dealing with a situation" in which the debtor has participated in an asset transfer to intentionally cheat a creditor out of money owed to it by someone else. *McClellan*, 217 F.3d at 896 (Ripple, J., concurring).

To be sure, those provisions do not apply in Chapter 13 proceedings. But neither did section 523(a)(2)(A) until Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), which extended some (but not all) of the Chapter 7 discharge bars to the Chapter 13 context. Congress thus cannot possibly have enacted section 523(a)(2)(A) to "serve[] an independent purpose ... in Chapter 13" cases, Pet.21, as section 523(a)(2)(A) did not even apply to Chapter 13 cases when it was enacted. Nor is petitioner's reading of section 523(a)(2)(A) needed to prevent "'especially clever' debtors" from "avoid[ing] any discharge bar by filing for bankruptcy under Chapter 13 instead of

Chapter 7" Pet.22. Congress made a conscious decision to keep "[a] discharge under Chapter 13 ... 'broader than the discharge received in any other chapter,'" *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 268 (2010), because a Chapter 13 bankruptcy requires approval and completion of a plan for *paying* the debtor's creditors. Allowing creditors to smuggle section 523(a)(6) claims into section 523(a)(2)(A) thus would undermine Congress's intent to encourage use of a provision under which creditors are more likely to be paid by expanding the scope of the discharge available upon completion of the plan.

Finally, petitioner's boundless construction of section 523(a)(2)(A) is not necessary to avoid any superfluity problems either. Although petitioner proceeds on the assumption that "actual fraud" must encompass a broader swath of conduct than "false pretense" or "false representation," this Court has recognized the possibility of "a case of false pretense or representation but not of fraud." *Field*, 516 U.S. at 70 n.8. That conclusion is perfectly consistent with the fact that "the statute *already* referred specifically to 'false representation[s]' before 1978," Pet.19, as Congress had *already* barred discharge of a "debt created by the fraud ... of the bankrupt" for more than a century as well. *See Neal v. Clark*, 95 U.S. 704, 706 (1877). The 1978 code just recodified that long-standing bar and added the caveat "actual." As the leading bankruptcy treatise thus explains, the "actual fraud" prong in section 523(a)(2)(A) was intended not to make any "change in the law as it existed prior to" 1978, but rather just "to codify case law as expressed in *Neal v. Clark*, which interpreted 'fraud' to mean

actual or positive fraud rather than fraud implied by law" 3 Collier on Bankruptcy ¶523.08[5], at 523-28 (16th ed.).

At bottom, petitioner's proffered interpretation of section 523(a)(2)(A) is irreconcilable with the text of the statute, the common-law torts that it incorporates, and the manner in which this Court has interpreted it. It is also irreconcilable with the "'well-known' guide that exceptions to discharge 'should be confined to those plainly expressed.'" *Kawaauhau v. Geiger*, 523 U.S. 57, 62 (1998) (quoting *Gleason v. Thaw*, 236 U.S. 558, 562 (1915)). The Fifth Circuit thus was correct to reject petitioner's argument that section 523(a)(2)(A) can apply to bar a debt that is not the product of some sort of misrepresentation that induced the creditor to part with whatever it is that gave rise to the debt.

III. Petitioner Could Not Prevail Even If The Court Were To Resolve The Question Presented In Its Favor.

Finally, this Court's review also is not warranted because even if this Court were to disagree with all three courts below as to the correct interpretation of section 523(a)(2)(A), that still would not change the ultimate outcome of this case. Respondent presented several alternative grounds in support of the judgment below, and while the Fifth Circuit saw no need to reach those issues, each is amply supported by the law and the facts. At a minimum, those issues could necessitate remand for further proceedings in a case that has already dragged on for over five years.

First, even if section 523(a)(2) did not require a misrepresentation that induced the creditor to part with something of value, petitioner would still need to

prove that respondent is liable for Chrysalis's debt as a matter of state law And to do so, petitioner must prove that respondent committed "actual fraud" under section 21.223(b) of the Texas Business Organization Code. The Bankruptcy Court and the District Court divided on how to interpret that state law provision, and the Fifth Circuit declined to resolve that disagreement in light of its holding that petitioner could not invoke section 523(a)(2)(A) anyway. Pet.App.6a. But Texas case law plainly supports the Bankruptcy Court's view that section 21.223(a) requires a misrepresentation to establish "actual fraud." *See* Pet.App.91a-92a (collecting cases). Even if it did not, the Fifth Circuit also declined to resolve respondent's alternative argument that the record does not support a finding of "actual fraud" even under the District Court's flawed reading of Texas law because, *inter alia*, the evidence does not support the Bankruptcy Court's finding that the transfers were not made for reasonably equivalent value. *See* Pet.App.3a n.1 (declining to resolve that question). To prevail on its claim that respondent owes it a debt that is nondischargeable under section 523(a)(2)(A), petitioner would need to prevail on all of those state law and evidentiary issues as well.

Moreover, even assuming petitioner could pierce the corporate veil to hold respondent liable for Chrysalis's debt, as noted, every court to consider the question agrees that section 523(a)(2)(A) applies only when "the debtor intended by the transfer to hinder his creditors," not when "the only evidence of [fraud] is the inadequacy of the consideration" for the transfer. 217 F.3d at 894; *see also In re Lawson*, 791 F.3d at 220. Although petitioner repeatedly tries to

portray this case as fitting into the former category, as noted, the courts below in fact did not find that respondent acted with intent to defraud for purposes of section 523(a)(2)(A). While the Bankruptcy Court found that he caused transfers to be made "without Chrysalis receiving reasonably equivalent value," Pet.App.81a, it did not find that he did so with intent to defraud petitioner. And each court below found, in the course of rejecting petitioner's section 523(a)(6) claim, that petitioner failed to prove that respondent "made the[] transfers *with the intent to harm*" petitioner. Pet.App.18a (emphasis added). That alone ought to suffice to defeat any argument that respondent committed the kind of "actual fraud" that the Seventh and First Circuits think section 523(a)(2)(A) covers, but at a bare minimum it is an alternative grounds for affirmance that unquestionably remains open to respondent.

All of that said, if the Court were inclined to resolve the question presented, it should do so in this Chapter 7 case, rather than the Chapter 13 context in which *In re Lawson* resolved it. As evidenced both by the foregoing and by the opinions in the two cases, the correct interpretation of section 523(a)(2)(A) may depend at least in part on the interpretation of provisions such as sections 523(a)(6) and 727(a)(2)—provisions that apply in Chapter 7 but not Chapter 13 proceedings. While it may matter a great deal to a Chapter 7 debtor whether those provisions are given a narrow or a broad reading, the same cannot necessarily be said of a Chapter 13 debtor. Moreover, this case also has the virtue of involving a full trial on all exceptions invoked, which would give the Court a more complete sense of the interplay between the facts

and the law, as well as among the potentially relevant statutory provisions. *In re Larson*, by contrast, was resolved on a motion to dismiss with no factual development. Accordingly, although the question presented does not arise with sufficient frequency to warrant its resolution in either context, if the Court is inclined to resolve it, it should do so in this Chapter 7 case, or at least in this case in combination with *In re Lawson*, so that the Court can fully consider the implications of the arguments in both contexts.

CONCLUSION

The Court should deny the petition.

Respectfully submitted,

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IN THE

Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC.

Petitioner,

v.

DANIEL LEE RITZ, JR.,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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October 13, 2015

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Petitioner demonstrated that certiorari should be granted because this case presents a clean vehicle to resolve an acknowledged circuit split on an important issue that arises frequently in bankruptcy. Respondent admits that the circuits are divided, does not dispute that the issue has arisen in at least 17 reported cases in recent years, and does not attempt to identify any obstacle that would prevent the Court from deciding the Question Presented. To the contrary, he tacitly concedes that there is no such vehicle problem by going out of his way to explain why this case is a *better* vehicle than *In re Lawson*, No. 15-113, which is likely to go to conference in January. *See* Opp. 11, 26 ("[I]f the Court [is] inclined to resolve the question presented, it should do so in this Chapter 7 case, rather than the Chapter 13 context [of] *In re Lawson*.").

Respondent nonetheless contends that the Question Presented has not arisen frequently enough to merit review; that certiorari should be denied because he may yet prevail in a future remand on alternative grounds that the Fifth Circuit declined to consider below; and that the decision below is correct. All of these arguments are meritless. The petition should be granted.

I. THE QUESTION PRESENTED IS IMPORTANT AND ARISES FREQUENTLY

At every turn, Respondent acknowledges that "the petition correctly identifies a circuit split." Opp. 1; *see also id.* at 10, 12. His principal argument against certiorari is that this admitted split is "shallow" and that the issue does not arise with enough "real frequency" for this Court's review. Opp. 12-16.

First, contrary to Respondent's characterization, the 17 recent cases that Petitioner has identified are hardly just a "handful." Opp. 12. They reflect a 2-1 split at the circuit level, two cases before bankruptcy appellate panels in the Sixth and Tenth Circuits, and another dozen cases in bankruptcy courts across the country. *See* Pet. at 14-16 & nn. 2, 3. That more than satisfies the standards for certiorari. *See* S. Ct. R. 10.*

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* The Court has recently granted certiorari to address statutory questions arising far *less* frequently. *See, e.g.*, *Harris v. Viegelahn*, 135 S. Ct. 1829, 1836 (2015) (granting certiorari to resolve a 1-1 split on whether "undistributed postpetition wages 'are to be returned to the debtor'" after conversion of a case from chapter 13 to chapter 7); *Clark v. Rameker*, 134 S. Ct. 2242, 2246 (2014) (granting review to resolve a 1-1 split on whether "inherited IRAs" qualify as exempt "'retirement funds'" in chapter 7 bankruptcy); Brief in Opposition, *Baker Botts L.L.P. v. ASARCO LLC*, No. 14-103, 2014 WL 4075961 at *14 (5th Cir. 2014) (unsuccessfully opposing certiorari on the availability of attorney's fees for the cost of litigating a bankruptcy fee application, where there was only a "nascent split of just two courts of appeals" and there had been "few decisions" on the issue by any court); Brief in Opposition, *Pacific Operators Offshore, LLP v. Valladolid*, No. 10-507, 2011 WL 178699, at *14-15 (9th Cir. 2011) (unsuccessfully opposing certiorari on the workers-compensation provision of the Outer Continental Shelf Lands Act, even though the issue arose "rarely," and only "two cases presenting the question, over twenty years apart, ha[d] reached any [other] court of appeals"); Brief in Opposition, *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, No. 11-166, 2011 WL 5014752, at *13 (7th Cir. 2011) (unsuccessfully urging denial where there was a "shallow," "two-court conflict," with "few decisions addressing the issue"); *cf. Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 557 (1990) (noting grant of certiorari without even a circuit split "[t]o address a conflict *among Bankruptcy Courts*" on whether "state-imposed criminal restitution obligations can[] be discharged in a Chapter 13 bankruptcy" (emphasis added)).

Moreover, the Question Presented is important even apart from how often it arises. As the First Circuit recognized, whether debtors should be allowed to subvert the equitable purposes of the Bankruptcy Code to escape liability for intentional fraud is inherently a "significant issue" of public importance. *In re Lawson*, 791 F.3d 214, 216 (1st Cir. 2015). And as the Seventh Circuit explained, the rule adopted by the Fifth Circuit threatens to encourage wrongful conduct and transform individual bankruptcy into an "engine for fraud." Pet. at 13-14 (quoting *McClellan v. Cantrell*, 217 F.3d 890, 893 (7th Cir. 2000)).

Second, Respondent attempts to minimize the significance of the Question Presented by asserting that "most frauds do involve misrepresentation." Opp. 12. He provides no evidence for that claim, and even if true, it would not show that the Question Presented is unimportant: Whatever form *most* fraud might take, there are *many* instances of fraud without any misrepresentation, as evidenced by the examples Petitioner has identified. And now that the Fifth Circuit has given debtors a green light to get away with such fraud, it is certain to become even *less* rare unless this Court steps in.

Third, Respondent argues that the Fifth Circuit's decision should be allowed to stand because other provisions of the Bankruptcy Code will protect against deliberate fraudulent-transfer schemes. He relies mainly on Section 523(a)(6), but "willful and malicious injury" under that provision is narrower than "actual fraud" under Section 523(a)(2). While "actual fraud" requires only a showing of intent to benefit oneself through a fraudulent scheme, the

"willful and malicious" standard of Section 523(a)(6) requires a higher showing of "actual intent to cause injury" to the victim. *Kawaauhau v. Geiger*, 523 U.S. 57, 61 (1998) (emphasis added). Respondent's contrary view that Section 523(a)(6) encompasses *all* instances of intentional fraud makes little sense because it would render superfluous the specific provision for "actual fraud" under Section 523(a)(2)(A). *Cf. Kawaahau*, 523 U.S. at 61-62 (cautioning that "willful and malicious injury" under Section 523(a)(6) should not be read so broadly as to "obviate the need for" other specific provisions of Section 523(a)).

Respondent also points to Section 727(a)(2)(A), which imposes an absolute bar to discharge against anyone who has fraudulently *transferred away* assets within "one year" before filing for bankruptcy. Opp. 13. But Respondent recognizes that this provision will be of no help where someone wrongfully *obtains* money through a fraudulent-transfer scheme and then seeks to evade liability through bankruptcy. As Respondent admits, this is the typical "fact pattern" that has played out not only in this case but also in *McClellan* and *Lawson*. *See id.* at 13, 20.

Respondent next suggests that fraudulent-conveyance statutes will solve the problem because they generally require fraudulently transferred assets to be "returned." Opp. 21. That is cold comfort because the assets have typically been dissipated by the time of bankruptcy, leaving no direct avenue of recovery for the creditor. Once again, that perfectly describes *McClellan*, *Lawson*, and this case. Accordingly, the only way to secure a just result is to bar the debtor from discharging the debt for the

money he fraudulently obtained, which the decision below makes impossible.

Finally, Respondent acknowledges that both Section 523(a)(6) and 727(a)(2) typically have *no application whatsoever* in Chapter 13 cases, where creditors will thus be left defenseless against the type of fraud at issue here if they cannot invoke Section 523(a)(2)(A). *See* Opp. 23. Respondent tries to spin this in his favor by claiming that Congress "inten[ded]" to "encourage [the] use of" Chapter 13 by "expanding the scope of [] discharge" to *affirmatively authorize* the discharge of debts for money wrongfully obtained through fraudulent means. *Id.* That is an implausible account of congressional intent, to say the least. Congress "has long prohibited debtors from discharging liabilities incurred on account of their fraud, embodying a basic policy animating the Code of affording relief only to an '*honest* but unfortunate debtor.'" *Cohen v. de la Cruz*, 523 U.S. 213, 217 (1998) (emphasis added). Congress may have wished to encourage the use of Chapter 13 instead of Chapter 7, but it would not have done so by rewarding *intentional fraud* as part of the bargain.

In short, there is no merit to Respondent's argument that the type of deliberate fraudulent-transfer scheme at issue here arises infrequently or can be adequately addressed by other provisions of the Bankruptcy Code. This case therefore presents an important question that warrants this Court's immediate review.

II. RESPONDENT'S CLAIM THAT HE WILL PREVAIL ON ALTERNATIVE GROUNDS ON REMAND IS IRRELEVANT AND INCORRECT

Respondent suggests that review should be denied because even if he loses on the Question Presented, he will prevail on remand on other grounds. That speculation provides no basis for denying review. Indeed, it is hard to take Respondent's argument seriously when he also contends that the same record on which he believes he will prevail on remand is a "*virtue*" that makes this case a *better* vehicle than *Lawson*. Opp. 26-27 (emphasis added). In any event, Respondent's optimism about his chances of prevailing on remand is misplaced.

1. Ignoring the theory of Petitioner's complaint, on which the Fifth Circuit based its decision as a matter of law, Respondent claims that Petitioner "failed to prove" that Respondent actually had fraudulent intent in carrying out his scheme. Opp. 24-27 From this, Respondent argues that this case "does not actually present the question that petitioner has posed," Opp. 14-15, and that granting review will not affect the outcome of the case, Opp. 24-27

As Respondent acknowledges, however, the Fifth Circuit "saw no need to reach" the factual issue of whether Respondent actually carried out his scheme with fraudulent intent, and thus "declined to address" it. Opp. 9, 24. Instead, the court held that *even if* Respondent acted with fraudulent intent as alleged, he did not commit "actual fraud" because he is not alleged to have made any *misrepresentation*. The correctness of that holding is squarely presented here.

Speculation that the Fifth Circuit might reach the same result on the basis of an alternative factual finding that it refused to make in the decision below is no reason to deny certiorari.

Indeed, Respondent's liability on remand will likely be a foregone conclusion if this Court reverses and holds that "actual fraud" can be based on fraudulent intent without any misrepresentation. Otherwise the Fifth Circuit would have had no reason to engage in a lengthy analysis—and to create an avowed circuit split—about whether the "actual fraud" bar can apply where there is fraudulent intent but no misrepresentation. If, as Respondent suggests, he did not commit "actual fraud" under any standard, it would have been far easier for the Fifth Circuit to so hold.

Moreover, while the Fifth Circuit did not reach the question, the district court found that Respondent acted "*for the purpose* of perpetrating . . . an actual fraud . . primarily for [his] direct personal benefit," when he "drained Chrysalis of funds and fraudulently transferred those funds to other entities under his control and/or ownership." Pet. App. 67a, 69a (emphasis added). That finding of actual fraudulent intent was necessary to the district court's holding that Respondent is personally liable to Petitioner under Texas Business Organizations Code § 24.005, which applies only in cases involving "actual intent to hinder, delay, or defraud" a creditor. Pet. App. 71a. Even Respondent does not dispute this point, conceding that "the District Court *did* suggest that the evidence was sufficient to demonstrate 'intent to commit actual fraud.'" Opp. at 14 n.3 (emphasis added). That same evidence of fraudulent

intent is likely to control the outcome of this case on remand.

2. Respondent further claims that he could not have committed "actual fraud" under Section 523(a)(2)(A) because the courts below found that he did not inflict any "willful and malicious injury" under Section 523(a)(6). *See* Opp. at 26. That argument fails for two reasons.

First, the lower courts' ruling on the Section 523(a)(6) issue was based on *procedural* grounds: "[Petitioner's] complaint ma[de] [only] a glancing reference to [Section 523(a)(6)]," which was "not enough to preserve a claim under this provision." Pet. App. 75a, 96a. And even if that claim had been properly alleged in the complaint, it was not developed: "no exhibits were introduced, no testimony was adduced, and no briefing was done relating to § 523(a)(6)." *Id.* That failure was particularly important in the Fifth Circuit's view because Fifth Circuit law requires "*explicit evidence*" to prove "willful and malicious injury" under Section 523(a)(6). Pet. App. 18a (citation omitted; emphasis added by Fifth Circuit). Petitioner faces no such procedural obstacles to proving "actual fraud" under Section 523(a)(2), which was the central focus of the litigation in all three courts below.

Second, as explained above, it makes perfect sense to say that a debtor committed "actual fraud" without inflicting any "willful and malicious injury," because the latter requires a higher showing of "actual intent to cause injury" to the victim. *Supra* p.4 (quoting *Kawaauhau*, 523 U.S. at 61). It is thus consistent to say, as the district court found here, that Respondent

engaged in actual fraud "for the purpose of . . . personal benefit," even though he may not have maliciously intended to cause injury as required under Section 523(a)(6). Pet. App. 68-69a, 72a. If anything, this aspect of the factual record only underscores why this case is a better vehicle than *Lawson*, where no factfinding has yet occurred. The district court's finding here that Respondent's scheme was driven by "fraudulent intent" virtually guarantees that the resolution of the Question Presented will determine whether he gets away with it. Pet. App. 69a.

3. Finally, Respondent contends that he may also prevail on remand on two other arguments that the Fifth Circuit declined to address—that he should not have been held personally liable under Texas law for the debt to Petitioner, and that the trial court erred in finding that his fraudulent transfers were not made for reasonably equivalent value. *See* Opp. 25. But because the Fifth Circuit did not reach either of these issues, they do not provide any basis for denying certiorari. This Court can and should grant review to resolve the Question Presented, and leave these separate issues to be addressed on remand if necessary.

III. THE DECISION BELOW IS WRONG

Petitioner demonstrated that for the past century at least, the common law has consistently used the term "actual fraud" to refer to deliberate fraudulent-transfer schemes. Accordingly, such schemes clearly fall under the category of "actual fraud" in Section 523(a)(2)(A), which is a "term of art[]" that "the common law has defined." *Field v. Mans*, 516 U.S. 59,

69 (1995). By that simple logic, Section 523(a)(2)(A) bars Respondent from discharging the debt that he owes to Petitioner for the money that he obtained by fraudulent means. *See* Pet. 16-18. Respondent tries but fails to resist that conclusion.

First, Respondent does not mention, much less refute, Petitioner's evidence that the common-law meaning of "actual fraud" has long encompassed deliberate fraudulent-transfer schemes. Instead, Respondent relies primarily on this Court's decision in *Field*, which considered the scope of "actual fraud" *in a case of alleged fraud by misrepresentation. See* Opp. at 17-18. As Petitioner has explained, however, *Field* had no reason to consider whether "actual fraud" might also include *other* types of fraud that do not involve misrepresentation. All parties agreed that there *was* a misrepresentation in that case, and the only question was what "level of reliance" a creditor must prove *when alleging that type of fraud. Field*, 516 U.S. at 63; *see* Pet at 18-19. Respondent has no answer to this point, so he tries to change the subject: He resorts to cherry-picking quotes from a scattering of treatises that address actual fraud in the context of misrepresentation, but nowhere does he attempt to establish that these definitions are *exclusive* of other common-law meanings. Nor does he attempt to engage with the many instances Petitioner has identified of the long-established usage of "actual fraud" to encompass deliberate fraudulent-transfer schemes. *See* Pet 16-18.

Second, Respondent argues that the statute's reference to money "obtained by" fraud somehow helps support his interpretation. He bases that claim on *Field*, where money had allegedly been obtained

by fraudulent misrepresentation, and the Court held that "some degree of reliance is required to satisfy the element of causation inherent in the phrase 'obtained by.'" Opp. 18 (quoting *Field*, 516 U.S. at 66). Once again, however, that says nothing about how the statute applies in *other* situations, where money is "obtained by" *other* fraudulent means that do *not* involve misrepresentation. Here, for example, the money that Respondent obtained through his fraudulent-transfer scheme was "obtained by" fraudulent means despite the absence of any misrepresentation or reliance.

Third, Respondent makes the same mistake by asserting that obtaining money "by" fraud must always involve "induc[ing] the creditor to part with his money or property." Opp. 19 (quoting *McClellan*, 217 F.3d at 896 (Ripple, J., concurring)). That is incorrect. In fact, the statute contains no requirement that the money or property be obtained *from* the creditor. Instead, Section 523(a)(2)(A) refers generally to any money or property that is "obtained *by*" actual fraud. That describes the situation here, where Respondent obtained money through a deliberate fraudulent-transfer scheme, just like the fraudsters in *Lawson* and *McClellan*.

Finally, Respondent's remaining arguments on the merits simply recapitulate his claim that, even without Section 523(a)(2)(A), other legal provisions will solve the problem of debtors using bankruptcy to escape liability after enriching themselves through deliberate fraudulent-transfer schemes. Opp. 21-23. Petitioner has already shown that this is wrong. *See supra* pp.4-5 (discussing Sections 523(a)(6) and 727(a)(2) of the Bankruptcy Code, as well as generic

fraudulent-transfer statutes such as 11 U.S.C. §§ 548-52). Accordingly, the simple reality is that if the Fifth Circuit's decision is allowed to stand, the Bankruptcy Code will leave creditors with no protection against unscrupulous actors who seek to enrich themselves through fraudulent schemes like the ones in this case, *McClellan*, and *Lawson*.

CONCLUSION

For the foregoing reasons, the petition for certiorari should be granted.

Respectfully submitted,

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No. 15-145

IN THE

Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC.,
Petitioner,

v.

DANIEL LEE RITZ, JR.,
Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

JOINT APPENDIX

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PETITION FOR CERTIORARI FILED JULY 30, 2015
CERTIORARI GRANTED NOVEMBER 6, 2015

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General Docket
United States Court of Appeals for the 5th Circuit

Court of Appeals Docket #: 14-20526 Husky International Elec, Inc. v. Daniel Ritz **Appeal From:** Southern District of Texas, Houston **Fee Status:** Fee Paid	**Docketed:** 08/13/2014 **Termed:** 05/22/2015

Case Type Information:
1) Bankruptcy
2) District Court
3)

Originating Court Information:
District: 0541-4 : 4:11-CV-3020
Originating Judge: Melinda Harmon, U.S. District Judge
Date Filed: 08/18/2011

Date NOA Filed:	**Date Rec'd COA:**
08/12/2014	08/12/2014

Prior Cases:
None
Current Cases:
None

Panel Assignment:
Panel: CES CDK JWE

Date of Hearing:	**Date of Decision:**	**Date Completed:**
04/07/2015	05/22/2015	05/22/2015

In the Matter of: DANIEL L. RITZ, JR., also known as Bo Ritz Debtor	
HUSKY INTERNATIONAL ELECTRONICS, INCORPORATED Appellant	Jeffrey Lee Dorrell Direct: 713-522-9444 Email: jdorrell@hanszenlaporte.com Fax: 713-524-2580 [COR LD NTC Retained] Hanszen & Laporte Suite 850 11767 Katy Freeway Houston, TX 77079
v.	
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In the Matter of: DANIEL L. RITZ, JR., also known as Bo Ritz Debtor
HUSKY INTERNATIONAL ELECTRONICS, INCORPORATED Appellant v. DANIEL L. RITZ, JR. Appellee

08/13/2014	BANKRUPTCY CASE docketed. NOA filed by Appellant Husky International Electronics, Incorporated [14-20526] (MAS)
08/21/2014	INITIAL CASE CHECK by Attorney Advisor complete, Action: Case OK to Process. [7711537-2] Initial AA Check Due satisfied. Electronic ROA due on 09/05/2014. [14-20526] (MAS)
09/03/2014	ELECTRONIC RECORD ON APPEAL FILED. Exhibits on File in District Court? Yes. Electronic ROA deadline satisfied. [14-20526] (SMH)
	* * *
11/17/2014	APPELLANT'S BRIEF FILED Brief NOT Sufficient as it requires an Appearance Form from counsel signing the brief. Additionally the

Brief requires corrected caption.

Instructions to Attorney: PLEASE READ THE ATTACHED NOTICE FOR INSTRUCTIONS ON HOW TO REMEDY THE DEFAULT. # of Copies Provided: 0 A/Pet's Brief deadline satisfied. Sufficient Brief due on 12/02/2014 for Appellant Husky International Electronics, Incorporated. [14-20526]

REVIEWED AND/OR EDITED - The original text prior to review appeared as follows:

APPELLANT'S BRIEF FILED by Husky International Electronics, Incorporated. *11/17/2014* Date of service: 11/17/2014 via email Attorney for Appellant: Dorrell; Attorney for Appellee: Weber. E/Res Brief Due on 12/22/14 for Appellee Daniel L. Ritz, Jr. [14-20526] (Jeffrey Lee Dorrell)

* * *

11/17/2014 RECORD EXCERPTS FILED. Record Excerpts NOT Sufficient as they require caption to be corrected.

Instructions to Attorney: PLEASE READ THE ATTACHED NOTICE FOR INSTRUCTIONS ON HOW TO

REMEDY THE DEFAULT. # of Copies Provided: 0 Sufficient

	Record Excerpts due on 12/01/2014 for Appellant Husky International Electronics, Incorporated [14-20526]
	REVIEWED AND/OR EDITED The original text prior to review appeared as follows:
	RECORD EXCERPTS FILED by Appellant Husky International Electronics, Incorporated. *11/17/2014* Date of service: 11/17/2014 via email Attorney for Appellant: Dorrell; Attorney for Appellee: Weber [14-20526] (Jeffrey Lee Dorrell)
11/17/2014	RECORD ON APPEAL FORWARDED. [14-20526] (CAG)
11/18/2014	BRIEF MADE SUFFICIENT filed by Appellant Husky International Electronics, Incorporated in 14-20526 [7778314-2]. Sufficient Brief deadline satisfied. Paper Copies of Brief due on 11/24/2014 for Appellant Husky International Electronics, Incorporated. [14-20526] (CAG)
11/18/2014	RECORD EXCERPTS MADE SUFFICIENT filed by Appellant Husky International Electronics, Incorporated in 14-20526 [7778354-2]. Sufficient Record Excerpts deadline satisfied. Paper Copies of Record Excerpts due on 11/24/2014

for Appellant Husky International Electronics, Incorporated. [14-20526] (CAG)

* * *

12/16/2014 APPELLEE'S BRIEF FILED. Brief NOT Sufficient as it requires an Appearance Form from counsel (Weber) signing the brief. # of Copies Provided: 0. E/Res's Brief deadline satisfied. Sufficiency of Brief due on 12/30/2014 for Appellee Daniel L. Ritz Jr. Reply Brief due on 01/02/2015 for Appellant Husky International Electronics, Incorporated. Paper Copies of Brief due on 12/23/2014 for Appellee Daniel L. Ritz Jr. [14-20526] REVIEWED AND/OR EDITED The original text prior to review appeared as follows: APPELLEE'S BRIEF FILED by Appellee Mr. Daniel L. Ritz, Jr. *12/16/2014.* Date of service: 12/16/2014 via email- Attorney for Appellant: Dorrell [14-20526] (William D. Weber)

12/16/2014 RECORD EXCERPTS FILED. # of Copies Provided: 0. Paper Copies of Record Excerpts due on 12/23/2014 for Appellee Daniel L. Ritz Jr. [14-20526] (Excess pages allowed in 12/18/14 order) REVIEWED AND/OR EDITED

	The original text prior to review appeared as follows: RECORD EXCERPTS FILED by Appellee Mr. Daniel L. Ritz, Jr. Date of service: 12/16/2014 via email Attorney for Appellant: Dorrell [14-20526] (William D. Weber)
	* * *
12/30/2014	APPELLANT'S REPLY BRIEF FILED
	* * *
02/24/2015	CASE CALENDARED for oral argument on Tuesday, 04/07/2015 in New Orleans in the West Courtroom - AM session. In accordance with our policy, lead counsel only will receive via email at a later date a copy of the court's docket and an acknowledgment form. All other counsel of record should monitor the court's website for the posting of the oral argument calendars. [14-20526] (SME)
04/07/2015	ORAL ARGUMENT HEARD before Judges Stewart, King, Elrod. Arguing Person Information Updated for: Jeffrey Lee Dorrell arguing for Appellant Incorporated Husky International Electronics; Arguing Person Information Updated for: William D. Weber arguing for Appellee Daniel L. Ritz, Jr. [14-20526] (SME)

05/22/2015	PUBLISHED OPINION FILED. [14-20526 Affirmed] Judge: CES , Judge: CDK , Judge: JWE Mandate pull date is 06/12/2015 [14-20526] (JMA)
05/22/2015	JUDGMENT ENTERED AND FILED. [14-20526] (JMA)
06/15/2015	MANDATE ISSUED. Mandate pull date satisfied. [14-20526] (RJd)

* * *

U.S. District Court
SOUTHERN DISTRICT OF TEXAS (Houston)
CIVIL DOCKET FOR CASE #: 4:11-cv-03020

Husky International Electronics, Inc
Assigned to: Judge Melinda Harmon
Case in other court: SDTX-Adversary, 10-03156
Cause: 28:0158 Notice of Appeal re Bankruptcy Matter (BA)

Date Filed: 08/18/2011
Date Terminated: 07/14/2014
Jury Demand: None
Nature of Suit: 422 Bankruptcy Appeal (801)
Jurisdiction: Federal Question

In Re

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V.

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Date Filed	#	Docket Text
08/18/2011	1	Clerks Notice of Filing of an Appeal under Bankruptcy Rule 8004. On 8/17/11, Husky International Electronics, Inc filed a notice of appeal. The appeal has been assigned to U.S. District Judge Melinda Harmon, Civil Action 4:11cv3020. Parties notified, filed. (Attachments: # 1 Notice of Appeal) (smurdock,) (Entered: 08/18/2011)
10/19/2011	2	Bankruptcy Record on Appeal. The attached documents represent all designated items to be included as the Record on Appeal in this matter, filed. (Attachments: # 1 Adversary

Date Filed	#	Docket Text
		case 10-3156 Docket Sheet, # 2 100 Addendum to record. # 3 101 Statement of Issues. # 4 103 Appellant's Designation) The following documents relate to the Appellant's designation # 5 72 Transcript 2/2/11, #6 Continuation 1, # 7 Continuation 2) # 8 73 Transcript 2/3/11, # 9 Continuation 1, # 10 Continuation 2, # 11 Continuation 3) # 12 80 Transcript 2/11/11) # 13 89 Memorandum, # 14 93 Transcript 2/10/11, # 15 Continuation 1, # 16 Continuation 2, # 17 94 Transcript 2/11/11, # 18 Continuation 1, # 19 Continuation 2) # 20 46 Transcript 7/13/11 09-39895). Modified on 10/20/2011 The following documents relate to the Appellee's designation. (Additional attachment(s) added on 10/20/2011: # 21 1 Complaint, # 22 8 Answer, # 23 61 Joint Pretrial Statement, # 24 Continuation 1, # 25 Continuation 2, # 26 77 Brief, # 27 81 Post Trial Brief, # 28 84

Date Filed	#	Docket Text
		Brief, # 29 87 Brief, # 30 90 Judgment) Designated hearing exhibits are available for review in the Clerk's Office. Modified on 10/20/2011 (smurdock,). (Entered: 10/19/2011)
10/20/2011	3	Notice of Docketing an Appeal under Bankruptcy Rule 8007(b). On 10/20/11, the appeal was transmitted to the U.S. District Court, assigned Judge Melinda Harmon, Civil Action 4:11cv3020. All appellate filings must now be made in the United States District Court with the civil action caption and case number. Parties notified, filed. (Attachments: # 1 Notice of Appeal, # 2 8004 Notice) (smurdock,) (Entered: 10/20/2011)
		* * *
12/05/2011	9	Appellant's BRIEF by Husky International Electronics, Inc, filed. (Dorrell, Jeffrey) (Entered: 12/05/2011)
01/06/2012	10	Appellee's BRIEF by Daniel Lee Ritz, Jr, filed. (Weber, William) (Entered: 01/06/2012)

Date Filed	#	Docket Text
		* * *
03/15/2012	16	REPLY to 10 Appellee's Brief, filed by Husky International Electronics, Inc (Dorrell, Jeffrey) (Entered: 03/15/2012)
		* * *
07/14/2014	20	OPINION AND ORDER Affirming Judge Bohm's Decision. Case terminated on July 14, 2014 (Signed by Judge Melinda Harmon) Parties notified. (rvazquez) (Entered: 07/15/2014)
08/12/2014	21	NOTICE OF APPEAL to US Court of Appeals for the Fifth Circuit re: 20 Order, Terminate Case by Husky International Electronics, Inc (Filing fee $ 505, receipt number 0541 13557731), filed. (Dorrell, Jeffrey) (Entered: 08/12/2014)
08/21/2014	22	Clerks Notice of Filing of an Appeal. The following Notice of Appeal and related motions are pending in the District Court: 21 Notice of Appeal. Fee status: Paid, filed. (Attachments: # 1 NOA) (smurdock, 4) (Additional attachment(s) added on 8/21/2014: # 2 Opinion, # 3

Date Filed	#	Docket Text
		Docket sheet) (smurdock, 4). (Entered: 08/21/2014)
08/26/2014	23	DESIGNATION of Record on Appeal by Husky International Electronics, Inc, filed. (Dorrell, Jeffrey) (Entered: 08/26/2014)
08/28/2014		Notice of Assignment of USCA No. 14-20526 re: 21 Notice of Appeal, filed. (blacy, 4) (Entered: 08/28/2014)

* * *

U.S. Bankruptcy Court
Southern District of Texas (Houston)
Adversary Proceeding#: 10-03156

Assigned to: Jeff Bohm
Lead BK Case: 09-39895
Lead BK Title: Daniel Lee Ritz, Jr.
Lead BK Chapter: 7
Demand: $182433000

Date Filed: 03/31/10

Date Terminated: 01/17/13

Nature[s] of Suit:
62 Dischargeability 523(a)(2), false pretenses, false representation, actual fraud
67 Dischargeability 523(a)(4), fraud as fiduciary, embezzlement, larceny
68 Dischargeability 523(a)(6), willful and malicious injury

Plaintiff

Husky International Electronics, Inc.

represented by **Jeffrey Lee Dorrell**
Hanszen Laporte
11767 Katy Fwy
Suite 850
Houston, TX 77079
713-524-9444
Fax: 713-524-2580
Email: jdorrell@hanszenlaporte.com
LEAD ATTORNEY

V

Defendant

Daniel Lee Ritz, Jr 738 Highway 6 South 230 Houston, TX 77079	represented by **William David Weber** Weber Law Firm 6666 Harwin Drive, Suite 220 Houston, TX 77036 713-789-3300 Fax: 713-893-6004 Email: wlf@weberlaw.com **Jeffrey S Williams** J S Williams and Associates P.O. Box 440443 Houston, TX 77244-0443 281-531-8700 Email: jswilliams100@earthlink.net *TERMINATED*: 05/11/2010 *LEAD ATTORNEY*

Filing Date	**#**	**Docket Text**
03/31/2010	1 (11 pgs)	Adversary case 10-03156. Nature of Suit: (62 (Dischargeability - 523(a)(2), false pretenses, false representation, actual fraud)), (67 (Dischargeability

		523(a)(4), fraud as fiduciary, embezzlement, larceny)), (68 (Dischargeability 523(a)(6), willful and malicious injury)) Complaint *to Deny Dischargeability of Debt* by Husky International Electronics, Inc. against Daniel Lee Ritz Jr. Fee Amount $250 (Dorrell, Jeffery) (Entered: 03/31/2010
03/31/2010		Receipt of Complaint (10-03156) [cmp,cmp] (250.00) Filing Fee. Receipt number 10117211. Fee amount $250.00. (U.S. Treasury) (Entered: 03/31/2010)
		* * *
04/07/2010	5	Summons Issued on Daniel Lee Ritz Jr. Date Issued 4/7/2010. (hler) (Entered: 04/07/2010)
04/08/2010	6	Summons Service Executed on Husky International Electronics, Inc. 4/7/2010. (Dorrell, Jeffery) (Entered: 04/08/2010)
		* * *
05/10/2010	8	Answer to Complaint (Related document(s):1 Complaint) Filed by Daniel Lee Ritz Jr. (mmap) (Entered: 05/10/2010)
		* * *
11/26/2010	24	Pre Trial Statement (Filed By

		Daniel Lee Ritz Jr.). (Attachments: 1 Exhibit List 2 Witness List 3 Proposed Findings & Conclusions) (Weber, William) (Entered: 11/26/2010)
		* * *
01/03/2011	34	Pre Trial Statement (Filed By Husky International Electronics, Inc.). (Dorrell, Jeffery) (Entered: 01/03/2011)
		* * *
01/11/2011	40	Motion to Quash or *Modify Subpoena Concerning Defendant* Filed by Daniel Lee Ritz Jr. (Attachments: 1 Trial Subpeona 2 Proposed Order) (Weber, William) (Entered: 01/11/2011)
01/11/2011	41	Motion for Expedited Consideration (related document(s): 40 Motion to Quash). Filed by Daniel Lee Ritz Jr. (Attachments: 1 Proposed Order) (Weber, William) (Entered: 01/03/2011)
		* * *
01/17/2011	43	Motion for Expedited Consideration (related document(s): 40 Motion to Quash). Filed by Daniel Lee Ritz Jr. (Attachments: 1

		Proposed Order) (Weber, William) (Entered: 01/17/2011)
		* * *
01/18/2011	45	Motion to *Exclude Defendant's Evidence and Reopen Discovery* Filed by Husky International Electronics, Inc. (Attachments: 1 Exhibit 1 2 Exhibit 2 3 Exhibit 3 4 Exhibit 4 5 Exhibit 5 6 Exhibit 6 7 Exhibit 7 8 Exhibit 8 9 Exhibit 9 10 Exhibit 10 11 Exhibit 11 12 Exhibit 12 13 Exhibit 13 14 Exhibit 14 15 Exhibit 15 16 Exhibit 16 17 Exhibit 17 18 Exhibit 18 19 Exhibit 19 20 Exhibit 20 21 Exhibit 21 22 Exhibit 22 23 Exhibit 23 24 Exhibit 24 25 Exhibit 25 26 Exhibit 26 27 Exhibit 27 28 Exhibit 28 29 Exhibit 29) (Dorrell, Jeffery) (Entered: 01/18/2011)
01/18/2011	46	Response (Filed By Husky International Electronics, Inc.). (Related document(s): 40 Motion to Quash, 43 Motion for Expedited Consideration) (Attachments: 1 Exhibit 1 2 Exhibit 2 3 Exhibit 3 4 Exhibit 4 5 Exhibit 5 6 Exhibit 6) (Dorrell, Jeffery) (Entered: 01/18/2011)
		* * *

01/18/2011	48	Order Set Hearing Motion To Quash (Related Doc # 40), Granting Motion For Expedited Consideration (Related Doc # 43) Hearing set for 1/19/2011 9:00 a.m. Signed on 1/18/2011. (rste) (Entered: 01/19/2011)
		* * *
1/18/2011	50	Order setting expedited hearing on Defendant's M/to Quash. Hearing set for 1/19/2011 at 9:00 a.m. Signed on 1/18/2011 (rste) (Entered: 01/20/2011)
01/19/2011	49	AO 435 TRANSCRIPT ORDER FORM. This is to order a transcript of Hearing held on 1/19/2011 before Judge Jeff Bohm (Original). Court Reporter/Transcriber: Judicial Transcribers (dcla) Modified on 1/20/2011 (dcla). Forwarded to transcriber. (Entered: 01/19/2011)
01/19/2011		Courtroom Minutes. Time Hearing Held: 9:00 A.M. Appearances: J.L. Dorrell, W.D. Weber. (Related document(s): 40 Motion to Quash or Modify Subpoena Concerning Defendant Filed by Daniel Lee Ritz, Jr. Arguments heard. Evidence presented. Witnesses: William D. Weber/Heather

Chaney/Daniel Lee Ritz, Jr. For the reasons stated on the record, Motion is Granted. Within 1 week, Mr. Weber to file a proposed order, signed by Mr. Dorrell. Defendant's Exhibits 1, 2.1 thru 2.6, 3.1 thru 3.11 and 4 are admitted. 1 Complaint. Trial date is set for 2/2/2011 at 01:30 P.M. at Houston, Courtroom 600 (JB). (vatt) (Entered: 01/27/2011)

* * *

01/21/2011	53	Transcript RE: Motion to Quash held on 01 19-11 before Judge Jeff Bohm. Transcript is available for viewing in the Clerk's Office. Filed by Transcript access will be restricted through 04/21/2011. (lmar) (Entered: 01/21/2011)
01/21/2011	54	BNC Certificate of Mailing. (Related document(s): 47 Order on Motion for Default Judgment) No. of Notices: 2. Service Date 01/21/2011. (Admin.) (Entered: 01/21/2011)

* * *

01/24/2011	57	Pre Trial Statement (Filed By Husky International Electronics, Inc.). (Related document(s): 26 Order on Emergency Motion (Adversary),

27 Generic Order (Adversary)) (Attachments: 1 Proposed Findings of Fact & Conclusions of Law 2 Husky's Memorandum of Law on Contested Legal Issues 3 Exhibit List #1 4 Exhibit List #2 5 Husky's Specific Objections to Ritz Trial Exhibits #1 6 Husky's Specific Objections to Ritz Trial Exhibits #2 7 Trial Witness List #1 8 Trial Witness List #2) (Dorrell, Jeffery) (Entered: 01/24/2011)

* * *

01/24/2011	59	Response (Filed By Husky International Electronics, Inc.). (Attachments: 1 Husky's Supplemental Specific Objections to Ritz Trial Exhibits Copy 2) (Dorrell, Jeffery) (Entered: 01/24/2011)
01/24/2011	60	Amended Pre Trial Statement (Filed By Daniel Lee Ritz Jr.). (Related document(s): 24 Pre Trial Statement) (Attachments: 1 Amended Exhibit List 2 Amended Witness List 3 Proposed Findings and Conclusions 4 Defendant's Objections to Plaintiff's Trial Exhibits) (Weber, William) (Entered: 01/24/2011)

01/26/2011	61	Joint Pre Trial Statement (Filed By Husky International Electronics, Inc.). (Attachments: 1 Husky's Proposed Findings of Fact and Conclusions of Law 2 Husky's Memorandum of Law on Contested Legal Issues 3 Husky's Exhibit List—Copy 1 4 Husky's Exhibit List—Copy 2 5 Husky's Specific Objections to Ritz Trial Exhibits—Copy 1 6 Husky's Specific Objections to Ritz Trial Exhibits—Copy 2 7 Husky's Trial Witness List—Copy 1 8 Husky's Trial Witness List—Copy 2 9 Husky's Supplemental Specific Objections to Ritz Trial Exhibits—Copy 1 10 Husky's Supplemental Specific Objections to Ritz Trial Exhibits—Copy 2 11 Ritz's Amended Witness List 12 Ritz's Objections to Husky's Exhibits 13 Ritz's Amended Exhibit List l4 Ritz's Proposed Findings of Fact and Conclusions of Law 15 Ritz's Memorandum of Law on Contested Issues of Law) (Dorrell, Jeffery) (Entered: 01/26/2011)

* * *

01/27/2011		Courtroom Minutes. Time Hearing Held: 9:00 A.M. Appearances: J.L. Dorrell, W.D. Weber. (Related document(s): 45 Motion to Exclude Defendant's Evidence and Reopen Discovery Filed by Husky International Electronics, Inc. Arguments heard. Witness: Daniel Lee Ritz, Jr. Hearing is continued to 2/2/2011 at 01:30 P.M. at Houston, Courtroom 600 (JB). 1 Pretrial Conference: Complaint. Trial remains set for 2/2/2011 at 01:30 P.M. at Houston, Courtroom 600 (JB). (vatt) (Entered: 01/27/2011)
		* * *
01/31/2011	65	Transcript RE: PRETRIAL CONFERENCE held on January 27, 2011 before Judge Jeff Bohm. Transcript is available for viewing in the Clerk's Office. Filed by Transcript access will be restricted through 05/2/2011. (lmar) (Entered: 01/31/2011)
		* * *
02/02/2011		Courtroom Minutes. Time Hearing Held: 1:30 P.M. Appearances: J.L. Dorrell, D.J. Farris, W.D. Weber. (Related

	document(s): 1 Trial: Day 1. Plaintiff invokes the rule. Plaintiff's case. Arguments heard. Evidence presented. Witnesses: Nicolas C. Davis/Daniel L. Ritz, Jr. Trial is continued to 2/3/2011 at 08:30 A.M. at Houston, Courtroom 600 (JB). Plaintiff's Exhibits 1 thru 4, 6, 7, and 167 thru 169 are admitted. (vatt) Modified on 2/3/2011 (vatt). (Entered: 02/02/2011)
02/02/2011	Courtroom Minutes. Time Hearing Held: 1:30 P.M. Appearances: J.L. Dorrell, D.J. Farris, W.D. Weber. (Related document(s): 45 Motion to Exclude Defendant's Evidence and Reopen Discovery Filed by Husky International Electronics, Inc. Hearing is continued to 2/3/2011 at 08:30 A.M. at Houston, Courtroom 600 (JB). (vatt) (Entered: 02/02/2011)
	* * *
02/03/2011	Courtroom Minutes. Time Hearing Held: 8:30 A.M. Appearances: J.L. Dorrell, D.J. Farris, W.D. Weber. (Related document(s): 1 Trial: Day 2. Plaintiff's Oral Motion to Use

		Deposition Transcript of Daniel L. Ritz, Jr. as Direct Evidence is Denied for the reasons stated on the record. Plaintiff's case continues. Arguments heard. Evidence presented. Witnesses: Daniel L. Ritz, Jr./Nancy K. Finney/James D. Rogers/Richard Holland. Trial is continued to 2/4/2011 at 11:00 A.M. at Houston, Courtroom 600 (JB). Plaintiff's Exhibits 171, 172, 174, and 175 are admitted. (vatt) (Entered: 02/03/2011)
02/03/2011		Courtroom Minutes. Time Hearing Held: 8:30 A.M. Appearances: J.L. Dorrell, D.J. Farris, W.D. Weber. (Related document(s): 45 Motion to Exclude Defendant's Evidence and Reopen Discovery Filed by Husky International Electronics, Inc. Hearing is continued to 2/4/2011 at 11:00 A.M. at Houston, Courtroom 600 (JB). (vatt) (Entered: 02/03/2011)
02/04/2011	70	BNC Certificate of Mailing. (Related document(s): 68 Notice of Filing of Official Transcript (Form)) No. of Notices: 2. Service Date 02/04/2011.

		(Admin.) (Entered: 02/04/2011)
02/07/2011	71	AO 435 TRANSCRIPT ORDER FORM. This is to order a transcript of Hearing held on 2/2/2011 and 2/3/2011 before Judge Jeff Bohm (Original). Court Reporter/Transcriber: Judicial Transcribers (dcla) Modified on 2/7/2011 (dcla). Forwarded Judicial Transcribers. Modified on 2/7/2011 (dcla). Judicial Transcribers unable to accept as a daily order due to length. Order forwarded to Exceptional Reporting. (Entered: 02/07/2011)
		* * *
02/08/2011	72	Transcript RE: TRIAL AND MOTION TO EXCLUDE EVIDENCE AND REOPEN DISCOVERY held on 2/2/11 before Judge JEFF BOHM. Transcript is available for viewing in the Clerk's Office. Filed by Transcript access will be restricted through 05/9/2011. (thud) (Entered: 02/08/2011)
02/08/2011	73	Transcript RE: TRIAL AND MOTION TO EXCLUDE EVIDENCE AND REOPEN DISCOVERY held on 2/3/11 before Judge JEFF BOHM.

		Transcript is available for viewing in the Clerk's Office. Filed by Transcript access will be restricted through 05/9/2011. (thud) (Entered: 02/08/2011)
02/09/2011	75	Notice of Filing of Official Transcript as to 72 Transcript, 73 Transcript. Parties notified (Related document(s): 72 Transcript, 73 Transcript) (jdav) (Entered: 02/09/2011)
02/10/2011		Courtroom Minutes. Time Hearing Held: 10:00 A.M. Appearances: J.L. Dorrell, D.J. Farris, W.D. Weber. (Related document(s): 45 Motion to Exclude Defendant's Evidence and Reopen Discovery Filed by Husky International Electronics, Inc. For the reasons stated on the record, Motion is Denied. 1 Trial: Day 3. Plaintiff's case continues. Evidence presented. Plaintiff's case rests. Oral Motion for a Directed Verdict by Defendant. Arguments heard. Oral Motion is Granted as to 523(a)(2)(A) and Denied as to 523(a)(4) & 523(a)(6). Defendant's case. Arguments heard. Evidence presented. Witnesses: Heather Cheaney/Daniel Lee Ritz, Sr./Craig Takacs/L. Andrew

		Wells. Trial is continued to 2/11/2011 at 10:00 A.M. at Houston, Courtroom 600 (JB). Plaintiff's Exhibit 5 and Defendant's Exhibits 38, 39, 42, 43, 55a, & 69 are admitted. (vatt) (Entered: 02/10/2011)
		* * *
02/11/2011		Courtroom Minutes. Time Hearing Held: 10:00 A.M. Appearances: J.L. Dorrell, D.J. Farris, W.D. Weber. (Related document(s): 1 Trial: Day 4. Defendant's case continues. Arguments heard. Witnesses: Marlin R. Williford/Daniel L. Ritz, Jr. Defendant's case rests. Closing arguments. Matter is taken under advisement. Defendant's Exhibits 1 thru 11, 32.1 thru 32.4, 45 thru 49, 56, 57, 59.1, 59.2, 60, 61.1 thru 61.3, 62.1 thru 62.3, 63.1 thru 63.17, 64.1 thru 64.18, 65, 66, 67, & 68.1 thru 68.18 are admitted. (vatt) Modified on 2/19/2011 (vatt). (Entered: 02/19/2011)
02/14/2011	77	Brief (Filed By Husky International Electronics, Inc.). (Dorrell, Jeffery) (Entered: 02/14/2011)
02/15/2011	78	AO 435 TRANSCRIPT ORDER

		FORM. This is to order a transcript of Hearing held on 2/11/2011 before Judge Jeff Bohm (Original). Court Reporter/Transcriber: Exceptional Reporting Services (dcla) (Entered: 02/15/2011)
03/02/2011	79	Brief (Filed By Daniel Lee Ritz Jr.). (Weber, William) (Entered: 03/02/2011)
03/02/2011	80	Transcript RE: CLOSING ARGUMENT held on 2/11/11 before Judge JEFF BOHM. Transcript is available for viewing in the Clerk's Office. Filed by Transcript access will be restricted through 05/31/2011. (thud) (Entered: 03/02/2011)

* * *

03/07/2011	84	Brief (Filed By Husky International Electronics, Inc.). (Related document(s): 79 Brief, 81 Brief) (Dorrell, Jeffery) (Entered: 03/07/2011)
05/10/2011	85	Notice and Order regarding exchanging of exhibits and witness lists in all contested matters and adversary proceedings. (Entered: 05/10/2011)

* * *

07/21/2011	87	Brief (Filed By Husky International Electronics, Inc.). (Dorrell, Jeffery) (Entered: 07/21/2011)
07/29/2011	88	AO 435 TRANSCRIPT ORDER FORM. This is to order a transcript of Trial held on 2/2/2011, 2/3/2011/, 2/10/2011 and 2/11/2011 before Judge Joff Bohm (Original). Court Reporter/Transcriber: Exceptional Reporting Services (dcla) Modified on 7/29/2011 (dcla). 2/2/2011 and 2/3/2011 previously ordered by this party. Partial of 2/11/2011 also previously ordered by this party. 2/10/2011 and remainder of 2/11/2011 electronically forwarded to Exceptional Reporting Services 7/29/2011. (Entered: 07/29/2011)
08/04/2011	89	Memorandum Opinion Regarding Plaintiff's Original Complaint. Signed on 8/4/2011 (Related document(s): 1 Complaint) (rste) (Entered: 08/04/2011)
08/04/2011	90	Judgment denying all relief requested by the Plaintiff. Signed on 8/4/2011 (rste) (Entered: 08/04/2011)

* * *

08/11/2011	93	Transcript RE: TRIAL DAY 3 held on 2/10/11 before Judge JEFF BOHM. Transcript is available for viewing in the Clerk's Office. Filed by Transcript access will be restricted through 11/9/2011. (thud) (Entered: 08/11/2011)
08/11/2011	94	Transcript RE: TRIAL - DAY 4 (CLOSING ARGUMENTS OMITTED) held on 2/11/11 before Judge JEFF BOHM. Transcript is available for viewing in the Clerk's Office. Filed by Transcript access will be restricted through 11/9/2011. (thud) (Entered: 08/11/2011)
08/12/2011	95	Notice of Filing of Official Transcript as to 93 Transcript, 94 Transcript. Parties notified (Related document(s): 93 Transcript, 94 Transcript) (kcraig) (Entered: 08/12/2011)
		* * *
08/17/2011	97	Notice of Appeal filed. (related document(s): 89 Opinion, 90 Judgment (Adversary)). Fee Amount $255. Appellant Designation due by 08/31/2011. (Dorrell, Jeffery) (Entered: 08/17/2011)
08/17/2011		Receipt of Notice of Appeal (10-03156) [appeal,ntcapl] (255.00)

		Filing Fee. Receipt number 11953632. Fee amount $ 255.00. (U.S. Treasury) (Entered: 08/17/2011)
08/17/2011	98	Election to Appeal to District Court. (Dorrell, Jeffery) (Entered: 08/17/2011)
08/18/2011	99	Clerk's Notice of Filing of an Appeal under Bankruptcy Rule 8004. On 8/17/11, Husky International Electronics, Inc filed a notice of appeal. The appeal has been assigned to U.S. District Judge Melinda Harmon, Civil Action 4:11cv3020. Parties notified (Related document(s): 97 Notice of Appeal) (smur) (Entered: 08/18/2011)
		* * *
08/31/2011	101	Addendum to Record on Appeal (related document(s): 97 Notice of Appeal, 98 Election to Appeal). (Dorrell, Jeffery) (Entered: 08/31/2011)
08/31/2011	102	Statement of Issues on Appeal (related document(s): 97 Notice of Appeal, 98 Election to Appeal). (Dorrell, Jeffery) (Entered: 08/31/2011)
09/01/2011	103	Appellant Designation of Contents For Inclusion in Record on Appeal (related

		document(s): 97 Notice of Appeal, 98 Election to Appeal, 101 Addendum to Record on Appeal). (Dorrell, Jeffrey) (Entered: 09/01/2011)
		* * *
10/20/2011	106	Notice of Docketing an Appeal under Bankruptcy Rule 8007(b). On 10/20/11, the appeal was transmitted to the U.S. District Court, assigned Judge Melinda Harmon, Civil Action 4:11cv3020. All appellate filings must now be made in the United States District Court with the civil action caption and case number. Parties notified (Related document(s): 97 Notice of Appeal) (smur) (Entered: 10/20/2011)
		* * *

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 14-20526

D.C. Docket No. 4:11-CV-3020

In the Matter of: DANIEL LEE RITZ, JR., also known as Bo Ritz,

Debtor

HUSKY INTERNATIONAL ELECTRONICS, INCORPORATED,

Appellant

v.

DANIEL LEE RITZ, JR.,

Appellee

Appeal from the United States District Court for the Southern District of Texas, Houston

Before STEWART, Chief Judge, and KING and ELROD, Circuit Judges.

J U D G M E N T

This cause was considered on the record on appeal and was argued by counsel.

It is ordered and adjudged that the judgment of the District Court is affirmed.

IT IS FURTHER ORDERED that appellant pay to appellee the costs on appeal to be taxed by the Clerk of this Court.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re: DANIEL LEE RITZ, JR. Debtor.	§ § § § §	Case No. 09-39895-H4-7 Chapter 7
HUSKY INTERNATIONAL ELECTRONICS, INC. Plaintiff, v. DANIEL LEE RITZ, JR. Defendant.	§ § § § § § § § §	Adversary No. 10-03156

JUDGMENT RELATING TO COMPLAINT TO DETERMINE DISCHARGEABILITY OF DEBT

[Adv. Docket No. 1]

On March 31, 2010, Husky International Electronics, Inc. (the Plaintiff) filed its Complaint to Determine Dischargeability of Debt. Daniel Lee Ritz, Jr. (the Defendant), who is the Debtor in the Main Case, filed an answer on May 10, 2010. This Court conducted a trial on January 27, February 2, February 3, February 10, and February 11, 2010. Simultaneously with the entry of this judgment on the docket, this Court's Memorandum Opinion regarding this dispute is also being docketed. For the

reasons set forth in the Memorandum Opinion, this Court finds that the relief requested by the Plaintiff should be denied. It is therefore:

ORDERED that all relief requested by the Plaintiff is DENIED.

Signed on this 4th day of August, 2011.

/s/ Jeff Bohm

Jeff Bohm

United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

HUSKY INTERNATIONAL ELECTRONICS, INC.	)	Case No. 10-3156-H4-ADV
Plaintiff,	)	Houston, Texas
v.	)	
DANIEL LEE RITZ, JR.	)	Wednesday, February 2, 2011
Defendant.	)	(1:40 p.m. to 3:01 p.m.)
	)	(3:24 p.m. to 5:13 p.m.)

TRIAL AND MOTION TO EXCLUDE EVIDENCE AND REOPEN DISCOVERY

BEFORE THE HONORABLE JEFF BOHM, UNITED STATES BANKRUPTCY JUDGE

* * *

NICHOLAS DAVIS, PLAINTIFF'S WITNESS, SWORN

[Page 17]

* * *

[Page 27]

BY MR. DORRELL:

Q And that would be the Defendant, this gentleman sitting here at the table to my left?

A Absolutely.

Q All right. Did he come to see you?

A No, sir, he called me on my cell phone number.

Q Have you ever actually met him?

A No, sir.

Q All right. And what did he say?

A The conversation was fairly brief. He called and asked me if there was any way that we could work with them to work out a payment plan on these bounced checks. He acknowledged that they had bounced. He understood that there was a concern and asked us if we could work with him. I told him that it was going to put my company into a severe financial distress.

I didn't have the wherewithal to work with him. He needed to, as he had done in the past on bounced checks, wire money immediately or we would have to pursue litigation. And he said, well, if we're talking about litigation, then I can't talk to you any more. And I said that's not true. All you need to do is wire the money and we won't be talking about litigation. And he said, well, we're talking about litigation. And he hung up.

Q And so when was this conversation, if you remember?

A On or about January 12th. I don't know the specific date, but it was a couple of days after we ceased making shipments to them.

Q Did you ever have any further conversations with Defendant, Mr. Ritz?

A No, sir.

Q Anyone else with Husky?

A No, sir.

Q Have any conversations that you know of?

A No, sir.

Q Anybody else from Chrysalis ever have any conversations with you?

A No, sir.

Q Was there ever any more contact between Husky and Chrysalis that you know of?

A Not that I am aware of.

Q All right, what happened next?

* * *

[Page 41]

Q Did Mr. Ritz ever disclose to Husky that Chysalis was transferring cash to other entities owned or controlled by Mr. Ritz?

A No, sir.

* * *

[Page 45]

Q And isn't it true that before Mr. Ritz called you in January of '07, you didn't even know who Mr. Ritz was, right?

A I had only heard the name and I did not know specifically who he was.

Q So you and him have never talked if you didn't know who he was?

A I already said that we had never spoken before that.

Q And Mr. Ritz never made any misrepresentations to you, did he?

A How could he if we hadn't of spoken?

* * *

[Page 68]

DANIEL RITZ, PLAINTIFF'S WITNESS, SWORN

* * *

[Page 84]

BY MR. DORRELL:

Q Did you personally contribute capital to Chrysalis Manufacturing many times?

A No.

Q Now, that testimony is also different from what you gave in your March 27th, 2008, deposition, isn't it, sir?

A Yes.

* * *

[Page 100]

Q Okay. Did you borrow any money from private individuals, sir, to put it into Chrysalis?

A Not personally, no, sir.

Q That's a little bit different than your testimony of March of 2008 too, isn't it, sir?

A Yes, sir.

Q What you actually said in March of 2008 was that you borrowed money from private individuals. Aren't those your exact words?

A Yes, sir.

Q And that's no longer your testimony today?

A Correct.

Q Were any of the infusions that were made documented with a note, by loan, a promissory note? There were like hundreds, weren't there?

A Yes, sir.

Q And out of those hundreds, how many of them were documented with a note?

A I could not find any evidence of any notes.

Q So that would be 'none', is that right?

A Yes.

* * *

Q Yes, sir. My question was: You say that the transfers of $1.2 million dollars to other entities that you owned or controlled was repaying previous loans, do you not? Is that not your position?

A No, that's not a hundred percent my position, no, sir.

Q Well, how many percent of it is your position?

A I think there are, of the $1.2 million you mentioned—

Q Yes, sir.

A —it looks like the evidence to me shows that there's probably about 200 to $250,000 of repayment of loans.

Q Okay. And none of those are documented with any notes or anything else?

A Correct.

Q That also is different from your testimony of March of 2008, isn't it, sir?

A You'd have to point that out to me.

Q I beg your pardon?

A I don't recall exactly what I said in 2008. I know—I believe, if you will, that we would find intercompany payables earmarked in the notes on the receivables line and payables line and things like that.

Q Why don't you just look at page 61 of your deposition?

A Okay.

MR. WEBER: Fifty-one?

MR. DORRELL: Sixty-one, line five.

BY MR. DORRELL:

Q Just tell me when you're there.

(Pause)

A Sixty-one, line five?

Q Yes, sir. Are you there?

A Yes.

'QUESTION: So the cash infusions that you made in some cases was money you were acquiring from other sources?'

Q Answer?

'ANSWER: Yes, sir.

Question: And when you infuse it into Chrysalis, was this documented in the form of a note or loan agreement or any such thing?'

Q Answer?

'ANSWER: Yes, sir, typically. I believe that's the case.

QUESTION: So we would find, if we looked in the right drawer, a series of loan

agreements or notes between you and Chrysalis?'

Q Your answer?

'ANSWER: Yes.'

* * *

[Page 106]

Q So, Mr. Ritz, I mean you testified pretty clearly that you were receiving preferred stock in Chrysalis in exchange for these infusions that you now say Chrysalis was obligated to repay, isn't that right?

A I—You know, first of all I think that this is—

Q No, no, Mr. Ritz, the question is: Isn't that right?

A I don't—I don't know, sir, no.

Q You don't know what?

A Not exactly—I don't think that's exactly right, no.

Q It's not exactly right that you testified you were getting preferred stock through the same transfers of money you now say are repayments of loans?

A No, I think it's exactly right that I thought that at the time and I wasn't real clear.

Q So your testimony is that you've thought that you had preferred stock and today you've discovered that you don't?

A No, I think that the timeline focused on everything from 2003 forward is what you were asking about here, and now you're being very specific

and pointing to the board relative to those transfers, and I don't—I don't think that's my belief, no.

Q Okay. I'm not sure I know what that means—

A Okay.

Q —but my question was: Are you saying that you did not get preferred stock now?

A Yes.

Q So all of this was just some kind of a hallucination where you talk about one million dollars worth of preferred stock?

A I don't think it was a hallucination. I frankly didn't know how it was accounted for.

Q Well, it's not a slip of the tongue, sir, is it?

A I'm not sure what you mean.

Q It's a completely different version of the facts, Mr. Ritz. That's what I mean.

A Right. I think I said earlier I believe that I have a much more full understanding of the facts now than I did then.

* * *

[Page 113]

Q Okay. Look at page 67 of the deposition. Tell me when you're there.

(Pause)

A Okay, I'm there.

Q Okay. The record reflects a recess from 11:55 to 1:27. That's about an hour and a half, right?

A Yes, sir.

'QUESTION: Back on the record after a lunch break. Mr. Ritz, you're still under oath. Did you have a chance to meet with your attorney during the lunch break?

ANSWER: Yes.

QUESTION: And without telling me anything you discussed with him, are you happy with the testimony you've given so far today?

ANSWER: Yes.

QUESTION: You don't wish to change anything?

ANSWER: No.'

Q Okay. That was your testimony then?

A Right.

Q So you obviously had an opportunity to speak with your lawyer to get any clarifications that you needed. I gave you many opportunities to change your testimony during this deposition, did I not? I did several of those.

A I believe you did, yes.

Q And yet you never changed it?

A Right.

Q And you had the opportunity, after you got the written transcript, to make written changes then too, didn't you, sir?

A I believe so, yes.

Q And you didn't do that?

A No, sir.

Q And yet in this lawsuit, you have come to court and you have made dramatic changes in the sworn testimony that you gave, isn't that true, sir?

A I think there are some changes, yes, sir.

* * *

[Page 131]

Q Well, Mr. Ritz, I'm going to ask it this way: You were the person who was running the show when it came to moving money around on Chrysalis as well as all of the rest of your corporations, these six that are listed on the demonstrative exhibit in front of you. And I've got to stand up to read them because I'm not sure I can remember them anymore. I'm specifically talking about Institutional Capital Management, Inc., Institutional Insurance Management, Inc., Virtra Merger Corporation, also known as ComCon Manufacturing, Dynalyst Manufacturing Corporation, CapNet Advisors, Inc., CapNet Risk Management, Inc., and CapNet Securities Corporation. You were the guy running the show on these when it came to moving the money, were you not?

A There was—I mean my—specifically I was not the person that typically made the transfers, but I would say I was typically responsible as a person of authority in those accounts.

Q Okay. So if money got moved, you knew about it and probably, in most cases, instructed it, correct?

A Yes.

* * *

UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

HUSKY INTERNATIONAL ELECTRONICS, INC.	)	Case No. 10-3156-H4-ADV
Plaintiff,	)	Houston, Texas
v	)	
DANIEL LEE RITZ, JR.	)	Thursday, February 3, 2011
Defendant.	)	(8:44 a.m. to 12:51 p.m.)
	)	(3:03 p.m. to 6:11 p.m.)

TRIAL AND MOTION TO EXCLUDE EVIDENCE AND REOPEN DISCOVERY

BEFORE THE HONORABLE JEFF BOHM, UNITED STATES BANKRUPTCY JUDGE

* * *

[Page 10]

DANIEL LEE RITZ, JR., PLAINTIFF'S WITNESS, SWORN

* * *

[Page 26]

BY MR. DORRELL:

Q So you did not mean to say then that—bear with me one second.

(Pause)

You did not mean to say then that Marlin Williford was personally responsible for the electronic

funds transfers from the Chrysalis Account Numbers 3575101 and 3246930, both held at Amegy Bank?

A That's been—that's my memory of it.

Q Which is your memory?

A That he did have some control over those transfers. That's my memory of it. I mean I—

Q Some control after you told him what to do?

A Well, I didn't give him specific instruction, I gave him general authority to act, and I think he did a good job in his discretion. I mean it's hard to remember every bit of that period, but I mean it was a big responsibility trying to meet the payrolls of all the companies.

Q Did you initiate some of the transfers of cash from Chrysalis to your various entities, sir?

A I'm certain that I did, yes.

Q Was that a positive?

A I'm certain that I did initiate some of the transfers, yes.

Q And did you authorize some of the transfers that you may not have initiated?

A Yes.

Q Did you initiate and authorize many of the transfers?

A Yes.

* * *

[Page 30]

BY MR. DORRELL:

Q The interrogatory asks for you to identify every person who caused any transfer of money to be made in any amount between November of 2006 and May of 2007 from Chrysalis to various entities.

A Okay.
Q Your answer as to Number 1 is what?
A Okay.
Q And as your lawyer requested, read the entire answer.
A Yes, sir.

"Marlin Williford"—

Q If you'd use your copy and I'll get that.
A Sorry.

> "Marlin Williford acted as CFO for both ComCon Manufacturing Services and Chysalis Manufacturing during the period 11 of 2006 to 2007 He was personally responsible for electronic funds transferred from Chrysalis Account 3575101 and 3246930, both held at Amegy Bank. These payments to ComCon Manufacturing were used to cover payroll for Chrysalis Manufacturing employees. Marlin was the primary person who managed these accounts. Defendant did not initiate nor authorize any of these transfers."

Q Yes, sir, Defendant was you, right?
A Yes.

* * *

[Page 32]

BY MR. DORRELL:

Q Now, Mr. Ritz, you're not going to say that it was Marlin Williford who made all of the transfers from Chrysalis to ComCon, are you?
A I'm not—frankly, I'm not sure who made all the transfers at this time and during this period of time.

Q Well, a moment ago I understood you to say that you were very sure that you initiated and authorized a large number of these transfers from Chrysalis to your various entities, did I hear that correctly?

A To the various entities, yes, sir.

Q And this particular one, ComCon, is the one that got the largest number of transfers, isn't it?

A Yes.

Q All right—

THE COURT: Hold on one second.

(Court confers with clerk)

You may proceed.

MR. DORRELL: Okay?

THE COURT: Thank you.

BY MR. DORRELL:

Q So your testimony today is completely different from what you said under oath in answer to Interrogatory Number 8, is it not, sir?

A Your going from various entities to specifically ComCon and, you know, my memory is that I was not making every decision about it and I didn't really recall a lot of this particular period, because from the time that ComCon was involved I think Mr. Williford made most of the decisions about these transfers.

MR. DORRELL: Objection, nonresponsive.

THE COURT: Sustained.

BY MR. DORRELL:

Q Mr. Ritz, today you have told us, and I thought very clearly, you were responsible for initiating and authorizing most of the transfers, at least most, if not

all, most of the transfers of cash from Chrysalis to your various entities, correct?

A Yes.

* * *

[Page 59]

Q Well, the issue in this trial is whether or not the transfers from Chrysalis to IIM and Chrysalis to ICM were fraudulent as to the rights of my client, Husky. Your contention, as I understand it, is that—

MR. WEBER: I object. That's a mischaracterization of the pleadings and the allegations. There's no fraudulent conveyance – no fraudulent conveyance pleadings involved in this case. It's not pled; it's just mischaracterization.

THE COURT: Mr. Dorrell, response?

MR. DORRELL: The entire case is a fraudulent transfer case. We list off—

THE COURT: I think Mr. Weber is saying you haven't pleaded Section 548, which would be a fraudulent conveyance action. I'm assuming that's what you are arguing, Mr. Weber.

MR. WEBER: Correct, your Honor. It's an (a)(2), (a)(4) and (a)(6) dischargeability, fraud, actual fraud, breach of fiduciary duty; (a)(4) and, frankly, (a)(6) I'm not sure of. But no fraudulent conveyance. He's arguing, basically, I guess verbally but not on the pleadings that the fact that this amounts to actual fraud, although clearly case law says there has to be a false representation involved. I just think it's—it is not even pled. That's my objection, your Honor.

THE COURT: Let me carry the objection. Would you ask the question again, please?

* * *

[Page 65]

Q Okay. So, nevertheless, you personally guaranteed up to a million dollars of credit for Virtra Merger.

A Yes.

Q And what does that mean exactly when you personally guarantee something alone?

A That means if the corporation cannot pay it, then I would owe it personally.

Q So it would be a good idea then to do anything you could to make sure the corporation pays that debt, correct?

A Yes.

Q And we've already I think established that you caused approximately $677,000 to be transferred from Chrysalis to Virtra Merger in that five-month period from November of—or six-month period from November of 2006 to May of 2007, correct?

A I think that I said I was aware of it. I don't think I said I caused it.

Q Well, the testimony will be as it was taken down.

In any event, would you agree with me that it would have been a personal benefit to you to have made sure in that way by transferring Chrysalis funds to VirTra that VirTra would be able to pay its loan?

A Under the supposition, yes, sir.

Q Okay. What does "under the supposition" mean?

A I don't think that happened. You're giving me a theoretical case. And, yes, if that case had occurred, that I don't believe did, it would have benefited me.

Q You don't think what occurred?

A I don't think there was an occurrence of that line of credit being paid from any of the funds that you've described here.

Q Well, do you know how much of it was drawn?

A I do not have any of those records, no.

Q All right. It certainly would have been beneficial to you for CapNet Securities to get its money back from Chrysalis; would it not?

A Yes, sir.

Q And it would have certainly been a benefit to you for this company called Clean Fuels or Gulf Coast Fuels to get its money back from Chrysalis, correct?

A Yes. I mean, generally, that's true. I was not as personally involved with that one as I was in the case of CapNet Securities; I was 85 percent shareholder.

Q I understand. But you're agreeing with me it would have been a personal benefit to you.

A Yes.

Q And we can certainly agree then that for Dynalyst Manufacturing to get $96,000 back from Chrysalis would also have been a personal benefit to you.

A Yes, sir.

Q Okay It would have personally benefited you for all of the entities that you owned an interest in to get $1.2 million, collectively, from Chrysalis; would it not?

A If it had net received $1.2 million, it would have benefited me, yes, sir.

Q Whatever the number is.

A Yes.

Q You agree that it was a benefit to you.

A If monies net of all the transfers load to these companies, collectively, it would have been a benefit to me. Yes, sir.

Q Now, I don't remember if we covered this before, but there were no repayment terms on any of these things that you characterize as loans from your various companies to Chrysalis, correct?

A For the most part I do not believe so, no.

* * *

UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

HUSKY INTERNATIONAL ELECTRONICS, INC.	)	Case No. 10-3156-H4-ADV
Plaintiff,	)	Houston, Texas
v.	)	
DANIEL LEE RITZ, JR.	)	Friday, February 11, 2011
	)	(10:55 a.m. to 1:28 p.m.)
Defendant.	)	(3:10 p.m. to 4:15 p.m.)
	)	(5:29 p.m. to 5:50 p.m.)

TRIAL – DAY 4
(CLOSING ARGUMENTS UNDER SEPARATE COVER)

BEFORE THE HONORABLE JEFF BOHM,
UNITED STATES BANKRUPTCY JUDGE

* * *

[Page 44]

DANIEL RITZ, PLAINTIFF'S WITNESS, SWORN

* * *

[Page 120]

BY MR. WEBER:

Q Let's take a look at the International Insurance Management sheet.

That's 26.1, and if you would, describe the bottom line of that analysis there please.

A Okay. It—for the record, it's Institutional Insurance Management.

Q I'm sorry.

A It's all right. It's—this particular shows that Chrysalis transferred to IIM, we'll call it, in the period from January of '06 to May of '07 approximately $358,000. It received from IIM 57—excuse me—$757,000, with a net difference being owed by Chrysalis back to IIM of $399,000.

Q And why were those payments made? A IIM—

Q 26.

A Yeah. You know, IIM was a place where I had discretion to be able to pay money to Chrysalis when it needed it. I was intent on meeting the payrolls for this company and—

Q Why did you have discretion? I mean—

A I owned 100 percent of the stock. I was the board basically and, you know, except for certain passthrough items, I conducted the business in it. So, it's not that I technically was that company, but I had discretion in order to act as officer, director to do these transfers. And I routinely did them on behalf of Chrysalis.

Q And continue with your reasons for making the transfers.

A So, we, you know, we typically had payroll overdrafts and other needs of the company, and it was, you know, when that was brought to me as something that needed to be handled so to speak, you know, I would find discretion where I could and make transfers to the company.

Q Would the answers to these questions be the same for 26.2 except for the fact that the time period of the analysis is a different time period?

A Yes, sir.

Q Let's move on to 27.1. Recap sheet for Institutional Capital Management. What is the bottom line result on that analysis?

A During the period, it shows that Chrysalis transferred approximately $11,290 more to Institutional Capital Management than it did receive.

Q Okay. And would the answers for 27.2—that's a similar analysis for the time period of April '06 through May of '07? A Yes, sir.

Q And what's the bottom line result, looking at it from that perspective?

A During that period, ICM actually paid more to make up the difference, and left Chrysalis owing ICM approximately a little over a thousand dollars.

Q Let's look at 28.1. CapNet Advisors/Chrysalis transfer recap. What's the bottom line result on that?

Well, before I do that—I'm sorry.

A Yeah.

Q I forgot to ask you, with respect to 27, what were the reasons for that transfer? Was it similar to what you just indicated with respect to Capital—IIM?

A Yes, sir. I—well, I mentioned earlier that IIM and ICM were companies where which I had a—some advisory capacity. I didn't typically get paid from Chrysalis or derive any fees, but in both those cases

those are pure transfers as it relates to no other detail of any interaction between the company other than in the short term borrowings.

In the case of 28.2—

Q Well, let me stop you.

A Okay.

Q With respect to Exhibit 26 IIM and 27 ICM, do you recall Ms. Finney's testimony as to how the transfers were booked for accounting purposes?

A Accounts payable/receivable between the companies.

Q And so, were they—booking it that way, would that be considered a capital infusion, or would that be considered a loan, or would there be some other proper characterization?

A No, all these were considered short term unsecured loans, I mean, between the companies. And they would have been booked either as APAR or alternatively due to or from as an intercompany transfer.

Q Was there a proper business purpose for all of these transfers back and forth? Was there a proper business purpose for all of these transfers back and forth?

A Yes, I think there was.

Q And describe the purpose.

A The purpose was is that, you know, we—each of these entities had invested in the company, they were intent on keeping Chrysalis active and, you know, they ultimately would have had a stake in its success.

And they, you know, it was my opinion as officer of the entities that made the investments that they were good investments and valid, and were, you know, would hope to see it through to fruition and return a capital.

* * *

[Page 132]

BY MR. WEBER:

Q Mr. Ritz, if you would, take a look at Exhibit 59.1, please. And describe—well look at 59.1 and 59.2 together please, and describe both of those documents.

A Yes, sir. I—in evidencing from the bank records that we had income at Chrysalis up and through the point of the sale of the plant, I went back and pulled every income ledger item that I could account for on all of the bank statements for Chrysalis during the periods from January of '06 through '07—May of '07, and I put them down from where which they came from in terms of the account.

And I made a summary of that in total, and listed it here.

Q So, is that a summary of what kind of entry?

A Of the income—

Q What was the source—

A —the revenue—excuse me, the revenue.

Q What was the source of the income? Was it from business operations, transfers into the account by other entities?

A Yeah, this—

Q Describe the source of the income.

A Okay. I need to be more thorough. I—we were trying to account not from anything related to any transfers other than revenue generated as a direct result of shipments made by the company and paid from customers.

In this case, the customers accounts as receivables were typically sold, so the evidence is that these are from the factoring company that typically owned the receivable, and they paid us as we generated them, pretty much on a daily basis as generated.

* * *

[Page 136]

CROSS EXAMINATION

BY MR. DORRELL:

Q Mr. Ritz, you left out the part about how you got preferred stock with exchange for transfers of cash to Chrysalis, didn't you?

A They weren't pertinent to this particular time period.

Q You left out the part about how there is no evidence of anything relating to the character of these transfers of money, didn't you, sir?

A I've testified as have others that we transferred them as intercompany short-term loans, and the intent was that they were daylight loans to accommodate payroll.

Q Yes, sir, and I think my point is the only evidence we have of that is your word, isn't it, sir?

A No, I think others testified to that as well.

Q You left out the part about how there was no documentation of the transfers to Dynalyst as notes or loans.

A I think that both Mr. Williford, Ms. Finney, and frankly, Mr. Takacs, although I—I apologize. I think he was not able to answer. But I think both of the other two suggested that they were intercompany transfers and documented in the records of the companies.

MR. DORRELL: Objection. Nonresponsive.

THE COURT: Sustained.

BY MR. DORRELL:

Q Mr. Ritz, my question was, you left out the part about how there is no documentation, there were no notes. Of all of these hundreds of transfers, there was not one single note that evidences an indebtedness, is there, sir?

A It's on—it's on the specific financial statements of each of the companies.

MR. DORRELL: Objection. Nonresponsive.

THE COURT: Sustained.

BY MR. DORRELL:

Q Mr. Ritz, do you mind answering the question that I asked?

A They were documented only in the financial records of the balance sheet.

Q So, your answer is, there are no notes, no loan documents, nothing that shows any repayment terms or in any other way evidences any obligation by Chrysalis to repay money to Dynalyst. Yes or no.

A No.

Q To VirTra Merger.

A I think there is evidence of notes with VirTra Merger.

Q Well, I thought you testified that you looked for it and couldn't find it.

A I think—that doesn't mean that it didn't exist. There was a note, and there's evidence of it.

Q Well, if there was, it doesn't exist today, to the best of your knowledge. It's certainly not in the courtroom.

A I think it does exist. I don't have it.

Q It's not in the courtroom and it's not in evidence.

A I don't have it, no, sir.

Q There is no evidence of a note or any repayment terms or any loan agreement between Chrysalis and ComCon.

A I think it's the same—

Q Which is the same company as VirTra.

A Yes, sir, it is.

Q There is no evidence of any note or loan or repayment terms between Chrysalis and CapNet Advisors, is there, sir?

A I think we—I've testified that those were for services. There should not have been any loan documents for that company.

Q So, the answer would be there are no loan documents or—

A That's correct.

Q —any obligation to repay; is that right?

A No note between the two companies.

Q And there is no loan or any—and no repayment terms or anything else to evidence any obligation by Chrysalis to repay any money that it might have received from CapNet Securities Corporation either, is it sir?

A No note specifically, no.

* * *

[Page 153]

REDIRECT EXAMINATION

BY MR. WEBER:

Q Take again a look at Exhibit 26.1, Mr. Ritz.

A Yes, sir.

Q And I forget the mistake. How much was the mistake?

A Well, it was approximately—

Q Nineteen thousand, did I hear?

A —nineteen thousand. Yes, sir.

Q Okay. Does it—take a look at the red part on the third page.

A Yes, sir.

Q There's really—that number shows—what does it show?

A It shows that IIM had paid into Chrysalis $399,000 more than it had received.

So, if we take that correction into account, we would have a $380,000 number approximately that—

Q So, in other words, it would still show that Chrysalis received from IIM $380,000 more than with the other way?

A Yes, sir.

* * *

UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

HUSKY INTERNATIONAL ELECTRONICS, INC.	Case No. 10-3156-h4-ADV
Plaintiff,	Houston, Texas
v.	
DANIEL LEE RITZ, JR.	Thursday, February 3, 2011
Defendant.	(8:44 a.m. to 12:51 p.m.)
	(3:03 p.m. to 6:11 p.m.)

TRIAL AND MOTION TO EXCLUDE EVIDENCE AND REOPEN DISCOVERY

BEFORE THE HONORABLE JEFF BOHM, UNITED STATES BANKRUPTCY JUDGE

* * *

[Page 114]

NANCY KNOX FINNEY, PLAINTIFF'S WITNESS, SWORN

* * *

[Page 128]

BY MR. DORRELL:

Q Is it your testimony that movements of cash among Mr. Ritz's entities, which is Chrysalis and the other entities we have just identified, was directed by anyone other than Mr. Ritz?

MR. WEBER: Objection.

THE WITNESS: No—

MR. WEBER: Leading.

THE COURT: Hold on a minute.

MR. WEBER: It's leading.

THE COURT: No; I'll overrule that.

THE WITNESS: No one else made—I didn't take direction from anybody else to move funds other than Mr. Ritz.

* * *

[Page 132]

BY MR. DORRELL:

Q Was it your impression, Ms. Finney, that the transfers from—strike that.

Were you involved in transfers of any money from the entities you see there on the exhibit to Chrysalis?

A Yes.

Q Was it your impression that these were loans or did you have an impression?

A We recorded them as a receivable payable, so it's kind of an unofficial loan.

Q Okay. And what documentation of the terms of the loans existed?

A They were not documented.

Q Why was that?

A They just weren't. It was, I guess, intended to be repaid and it was just there were no loan documents. They weren't official loans. There was no interest-bearing instrument.

Q Did Mr. Ritz ever tell you that he didn't want any documentation?

A I don't remember that.

Q Okay. Is it possible that somebody was supposed to be responsible for documenting these loans and then just failed to do it?

A No.

Q No?

A No.

Q Why is that not possible?

A Because it probably would have been me, and I was never told to do it.

* * *

[Page 140]

Q Do you have an opinion as to Mr. Ritz's character for truthfulness?

A I can testify for my dealings with him.

Q Yes, ma'am.

A I never just—there were other issues where I was told one thing and it just flat out didn't happen.

Q So your opinion of Mr. Ritz's character for truthfulness would be what?

A Poor.

* * *

UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

HUSKY INTERNATIONAL ELECTRONICS, INC.	Case No. 10-3156-h4-ADV
Plaintiff,	Houston, Texas
v.	
DANIEL LEE RITZ, JR.	Thursday, February 3, 2011
Defendant.	(8:44 a.m. to 12:51 p.m.)
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TRIAL AND MOTION TO EXCLUDE EVIDENCE AND REOPEN DISCOVERY

BEFORE THE HONORABLE JEFF BOHM, UNITED STATES BANKRUPTCY JUDGE

* * *

[Page 156]

* * *

JAMES DAVID ROGERS, PLAINTIFF'S WITNESS, SWORN

* * *

BY MR. DORRELL:

Q Mr. Rogers, what was your connection with Mr. Daniel Lee Ritz, Jr.?

A I worked for the CapNet organization between January of '04 and January of '07 except for a brief

spell in '05. And I worked for ICM for a year-and-a-half before that.

Q What was your title?

A When I left I was the vice president of corporate finance.

Q For which entity?

Q CapNet Securities.

A Did you have a business card?

A Yes.

Q What did that say that your title was?

A Vice President of Corporate Finance.

Q Were you the vice president of corporate finance for any other entities that were under control by Mr. Ritz?

A No.

Q As vice president of corporate finance what were your duties or areas of responsibility?

A Well, it was to examine the deal flow, look at opportunities, see what looked good, what didn't; also to—for those who wanted a deal I would prepare the offering documents if we were going to raise capital.

Q Okay. Did you have access to financial records of all of Mr. Ritz's companies?

A Of all the portfolio companies, yes.

Q And what does that mean?

A The companies that had been invested in like Dynalyst and Altatron and Virtra Merger. I did not see or have need to see CapNet Securities or those other companies.

Q Yes, sir. Thank you. Tell me, sir, was there any doubt in your mind about who was running the show financially speaking at the Ritz companies that you were involved with?

A Any doubt in my mind?

Q Yes, sir.

A No, sir.

Q Who was it?

A Ritz.

Q And that's the Mr. Ritz who's the Defendant in this case sitting at the table to my left?

A Yes, sir.

Q Okay. Not his father.

A No.

* * *

[Page 165]

BY MR. WEBER:

Q: Were you aware of any direct dealing between Mr. Ritz and Husky International or any of Husky International's employees or representatives?

A No.

* * *

UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

HUSKY INTERNATIONAL ELECTRONICS, INC.	)	Case No. 10-3156-h4-ADV
Plaintiff,	)	Houston, Texas
v.	)	
DANIEL LEE RITZ, JR.	)	Thursday, February 3, 2011
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	)	(3:03 p.m. to 6:11 p.m.)

TRIAL AND MOTION TO EXCLUDE EVIDENCE AND REOPEN DISCOVERY

BEFORE THE HONORABLE JEFF BOHM, UNITED STATES BANKRUPTCY JUDGE

* * *

[Page 168]

* * *

RICHARD HOLLAN, PLAINTIFF'S WITNESS, SWORN

* * *

[Page 172]

BY MR. DORRELL:

Q So as you sit here today, you would consider that Mr. Ritz still owes you $700,000?

A I am a creditor in Mr. Ritz's overall bankruptcy.

Q All right. And I mean, how do you feel about Mr. Ritz because of this?

A I mean—

MR. WEBER: Your Honor, I object. That's immaterial how he feels about Mr. Ritz.

THE COURT: I'll sustain the objection. I think you need a little—put more meat on the bone, if you will. If you want—I mean, you asked the question correctly with respect to when Ms. Finney was on the stand. But that is such a scattershot the way you phrased it I'll sustain.

BY MR. DORRELL:

Q You don't have a very high opinion of Mr. Ritz today, do you?

A Well, no, I do not.

* * *

UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

HUSKY INTERNATIONAL ELECTRONICS, INC.	)	Case No. 10-3156-H4-ADV
	)	
	)	Houston, Texas
Plaintiff,	)	
v.	)	Friday, February 10, 2011
DANIEL LEE RITZ, JR.	)	(10:09 a.m. to 11:16 p.m.)
	)	(1:17 p.m. to 2:37 p.m.)
Defendant.	)	(2:56 p.m. to 3:37 p.m.)

TRIAL – DAY 3

BEFORE THE HONORABLE JEFF BOHM,
UNITED STATES BANKRUPTCY JUDGE

* * *

[Page 25]

MR. DORRELL: Our contention about fraud is that the fraud was not the common-law fraud that requires an affirmative misrepresentation that was relied upon to the detriment and damages. Our contention is that the actual fraud that causes the discharge is the actual fraudulent transfers of money which Mr. Ritz caused to happen from Chrysalis to his other entities.

* * *

[Page 28]

MR. DORRELL: I have two points to make, yes.

THE COURT: Yeah, go ahead.

MR. DORRELL: I will concede that we are making a somewhat nontraditional use of *The Texas*

Uniform Fraudulent Transfer Act because typically this is done TUFTA or Section 548 with a trustee or some creditor seeking to avoid the transfers and recapture the money.

THE COURT: Right.

MR. DORRELL: We have a little bit different situation here because what we're saying is that this can constitute the fraud under Texas Business Organizations Code, Section 21. 223 that makes this Debtor individually liable for the corporate contractual debt of the company he caused the transfer.

THE COURT: And you may have a compelling argument on that issue under 523(a)(4), fraud while acting in a fiduciary capacity but 523(a)(2)(A) is a very, very precise statute and it—and the case law on it says that Element Number 1 is the Debtor made a representation and so I understand what you're saying. I understand your argument but I don't feel comfortable jurisprudentially of taking your argument, the 548 argument and bootstrapping it into 523(a)(2)(A).

MR. DORRELL: Then let me say two more things.

THE COURT: Please.

MR. DORRELL: I understand the Court's—I mean, we did—this is not a new discovery for us today.

THE COURT: Yeah.

MR. DORRELL: We did some struggling with this ourselves and there are many strategic reasons why we chose to approach it this way—

THE COURT: I understand.

MR. DORRELL: —which probably the Court can easily understand. The first point I would make is I don't think that Judge Lynn is actually foreclosing the possibility of fraudulent transfer being an actual fraud. I think he is speaking in the context of the more traditional use which relies on the common-law elements of fraud, that being he's just saying the elements that we all know are the common-law causes of action for fraud, a representation relied upon to the detriment with damages. I don't think that forecloses any other form of fraud. We know that the law recognizes not only fraud by affirmative representation but also fraud by nondisclosure. There is evidence in this case—

THE COURT: Stop. And it's that fraud in Section 523(a)(4) that I think covers it and so the fraudulent acts, the badges of fraud that you have been addressing and for which I believe there is evidence I think you can fit into 523(a)(4). You also have to prove, as you know, fiduciary duty but the 523(a)(2)(A), as I read the case law, you have to show—you have to prove that the Defendant made a representation. You don't have to prove Defendant made a representation under 523(a)(4), at least from my reading of the case law but under 523(a)(2)(A), you do and that's why, as I've said jurisprudentially, I don't feel comfortable with your argument as to 523(a)(2)(A). Over on 523(a)(4), I'm more comfortable with it.

* * *

UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

HUSKY INTERNATIONAL ELECTRONICS, INC.	)	Case No. 10-3156-H4-ADV
	)	
	)	Houston, Texas
Plaintiff,	)	
v.	)	Thursday, February 11, 2011
DANIEL LEE RITZ, JR.	)	(10:55 a.m. to 1:28 p.m.)
	)	(3:10 p.m. to 4:15 p.m.)
Defendant.	)	(5:29 p.m. to 5:50 p.m.)
	)	

TRIAL – DAY 4

(CLOSING ARGUMENTS UNDER SEPARATE COVER)

BEFORE THE HONORABLE JEFF BOHM, UNITED STATES BANKRUPTCY JUDGE

* * *

[Page 11]

MARLIN WILLIFORD, DEFENDANT'S WITNESS, SWORN

* * *

[Page 42]

BY MR. DORRELL:

Q And as a result, sir, what is your opinion of Mr. Ritz's character for truthfulness?

A Well, these statements I've said are not true.

Q And do you know of other statements Mr. Ritz has said that are not true?

A Well, I'd rather speak to just what's on the record if I may.

Q What I need you to speak to, Mr. Williford, is your opinion of Mr. Ritz's character for truthfulness. You've told us you have one. Can you tell us what it is?

A Well, like I said, in reading these things I was disappointed that I did not believe them to be truthful. You know, in that respect I would say that that was not true.

* * *

UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

HUSKY INTERNATIONAL ELECTRONICS, INC.	)	Case No. 10-3156-H4-ADV
Plaintiff,	)	Houston, Texas
v.	)	
DANIEL LEE RITZ, JR.	)	Friday, February 11, 2011 (5:50 p.m. to 6:52 p.m.)
Defendant.	)	

CLOSING ARGUMENT

BEFORE THE HONORABLE JEFF BOHM,
UNITED STATES BANKRUPTCY JUDGE

* * *

[Page 38]

THE COURT: All right; let's make it clear. I am absolutely concluding that those transfers out of Chrysalis were not repayment of loans, based upon the Fifth Circuit case I've cited.

MR. WEBER: I understand, your Honor.

THE COURT: Okay. You've preserved any point for appeal, Mr. Weber; there is no question about that. But I can assure you, you won't change my mind on that one.

* * *

[Page 40]

MR. DORRELL:

I believe, respectfully, that Mr. Weber is conflating the law and the approach of an action for avoidance of a fraudulent transfer and the action we have here, which is to hold a shareholder personally liable for corporate contractual debt. I think the pro rata analysis is correct if this was a TUFTA, or a Section 548 action to avoid a fraudulent transfer. I think it is not correct when the issue is: Did Mr. Ritz cause Chrysalis to be used to perpetrate an actual fraud on Husky for his direct, personal benefit? When those showings are made, as I think they were here, then Mr. Ritz becomes personally liable for the entire amount of the corporate contractual debt and there is not a pro rata analysis. I have not briefed that; that is my belief of the state of the law on it.

* * *

UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE:	)	
	)	Case No. 09-39895-H4-7
DANIEL LEE RITZ, JR.,	)	Houston, Texas
Debtor.	)	Wednesday, July 13, 2011
	)	(9:39 a.m. to 9:56 a.m.)

AMENDED TRANSCRIPT

STATUS CONFERENCE

BEFORE THE HONORABLE JEFF BOHM,
UNITED STATES BANKRUPTCY JUDGE

* * *

[Page 7]

THE COURT:

* * *

I have some comments. As Mr. Dorrell and Mr. Weber know, we had a trial in my court, down on the fourth floor because there were some renovations going on in this court, and I'm sure everyone is wondering how come I haven't issued a ruling. I will tell you I've been on the bench for six and a half years. I try to get my rulings done quickly, sometimes from the bench, sometimes in writing. I felt that it was important to reduce my thoughts to

writing on this one, particularly when I'm dealing with 523 actions and 727 actions I try to reduce my thoughts to writing because when you start either denying a discharge, you know, under 727 or deny a specific discharge or a specific debt under 523 it's serious and I feel that I should reduce—if I can I reduce my thoughts to writing so that if anyone wants to appeal me an Appellate Court has got, you know, something in writing they can look at.

And I have spent an enormous amount of time, very candidly, given the testimony I heard, trying to come to a landing as to how to deny the discharge of the debt owed to Huskie, because, as my written order or my written memorandum will set forth, I don't believe Mr. Ritz. I found him to be a witness with virtually no credibility. I think he drained Chrysalis of a lot of money. But unfortunately, based upon the law I have, the statute that the Texas Legislature passed, I have concluded that the debt is dischargeable. In other words, based upon the law that I am dealing with and based upon the testimony I have, I've got no representations that Mr. Ritz made to Huskie, I have concluded that the Complaint must fail.

I don't think I've ever said this on the record, but I'm going to say it now. I hope you do appeal me. I hope an Appellate Court tells me I'm wrong, because I don't believe Mr. Ritz. I think he was trying to drain that company. I have to say that the Texas Legislature passed the statute that it did. I've got the testimony that I do and the evidence that I've got. I think that what he did was wrong insofar as I don't think people ought to be draining corporations of money. But the Texas Legislature has clearly in

recent years passed legislation that shields officers and directors more than it has in the past. And there may be good reasons for so doing it and I'm not going to get into that.

And in effect, and I'm working on it right now, the best I can tell what should have happened under Texas State law, if I draw the inference correctly, is that Huskie should have in effect sought a or prosecuted a derivative action on behalf of Chrysalis against Mr. Ritz and assuming it prevailed in effect would have had to have Chrysalis be in a bankruptcy and ask the Trustee of Chrysalis to pursue a derivative action, one of those scenarios. In effect I'm saying based upon the Texas legislation that was recently passed, I think it was '09 or '07, that you've got to do a derivative action on behalf of all creditors. That's the inference I ended up drawing.

In any event I will tell you I'm very unhappy with the result, but I'm trying to adhere to my oath. My oath is to look at the evidence and Mr. Ritz made no representation to Huskie before Huskie shipped the goods and I couldn't find anything, and, believe me, I've been looking long and hard, there were lots of exhibits, I can't find anything to show any kind of representation.

So I'm trying to put the finishing touches on the opinion and there was another wrench is when the Supreme Court came out with this recent *Marshall* case I had to stop and say okay, do *I* have constitutional authority to sign a final judgment. And I've been doing that on everything that I'm working on now. It took me a while. I've read the opinion several times. I have concluded that I do

have constitutional authority to sign a final judgment in this case. But that's yet another issue. If I don't, then I ought to be making recommendations to a District Judge.

So, Mr. Dorrell, if your client decides to appeal, that may be another issue you can raise. I think I do have constitutional authority to sign a final judgment, but if you think I'm wrong you can raise it with the District Court. Because if I'm wrong, then it means the District Court can review everything de novo.

So I wanted to alert you all to that. And Mr. Dorrell and Mr. Weber, I thought you tried the case well and you cited the law correctly on behalf of each of your clients and I and several other people have looked at this. So I'm sure that Mr. Ritz will be pleased and I'm sure that Huskie's owners will not be pleased. You can tell them that I said on the record, Mr. Dorrell, that I thought you did a first-rate job. I mean it's not—this is one of those cases where it's not your fault that the facts aren't the way that

* * *

[Page 11]

So bear with me, I'll get it out. Like I said, I hope you do appeal me, maybe an Appellate Court can find some way, because what I think—I think what Mr. Ritz did should not be allowed. But that said, if I think that way I need to quit this job and go run for the Legislature and pass legislation. Right now I'm going to enforce the legislation as it has been passed and I think I'm required to do.

* * *

EXHIBIT 26.1

IIM - Chrysalis - Transfer Recap Sheet
(1/1/06 - 5/21/07)

IIM to Chrysalis

Chrysalis to IIM

Date	Method	Chrysalis to MM	IIM to Chrysalis	Net
1/4/2006			55,000	(55,000)
1/6/2006			90,000	(145,000)
1/11/2006			25,000	(170,000)
1/12/2006			50,000	(220,000)
1/17/2006			50,000	(270,000)
1/23/2006		27,000		(243,000)
1/25/2006		15,000		(228,000)
1/25/2006		10,000		(218,000)
1/27/2006			5,000	(223,000)
1/31/2006		10,000		(213,000)
2/2/2006		35,000		(178,000)
2/6/2006			50,000	(228,000)
2/7/2006			27,000	(255,000)
2/8/2006			5,000	(260,000)
2/9/2006		10,000		(250,000)
2/13/2006			3,000	(253,000)
2/16/2006		30,000		(223,000)
2/22/2006			80,200	(303,200)
2/22/2006		50,000		(253,200)
3/6/2006			100,000	(353,200)
3/7/2006			30,000	(383,200)
3/9/2006			2,000	(385,200)
3/10/2006			6,800	(392,000)
3/24/2006		12,500		(379,500)

4/4/2006			30,000	(409,500)
4/11/2006			9,950	(419,450)
4/13/2006			25,000	(444,450)
4/28/2006		9,000		(435,450)
7/12/2006			4,000	(439,450)
7/12/2006			6,000	(445,450)
7/13/2006			20,750	(466,200)
7/13/2006			10,750	(476,950)
7/17/2006			8,000	(484,950)
7/17/2006			1,800	(486,750)
8/11/2006			5,200	(491,950)
8/16/2006		1,300		(490,650)
8/16/2006		5,450		(485,200)
8/16/2006		1,400		(483,800)
8/16/2006		1,000		(482,800)
10/16/2006		650		(482,150)
11/10/2006		2,200		(479,950)
11/28/2006			6,000	(485,950)
12/7/2006			5,000	(490,950)
12/7/2006		5,000		(485,950)
12/13/2006			25,300	(511,250)
12/14/2006			1,300	(512,550)
12/15/2006			2,060	(514,610)
12/18/2006			400	(515,010)
12/18/2006		400		(514,610)
12/20/2006		3,000		(511,610)
12/20/2006		2,000		(509,610)
12/21/2006		5,200		(504,410)
12/22/2006		4,000		(500,410)
12/27/2006		2,500		(497,910)
1/8/2007			500	(498,410)
1/9/2007			2,950	(501,360)
1/12/2007		8,050		(493,310)
1/16/2007			4,400	(497,710)
1/17/2007		2,400		(495,310)
1/17/2007		1,000		(494,310)
1/17/2007		155		(494,155)

1/19/2007		4,600		(489,555)
1/19/2007		1,000		(488,555)
1/22/2007		2,800		(485,755)
1/30/2007		2,500		(483,255)
1/30/2007		1,000		(482,255)
1/31/2007		3,020		(479,235)
2/2/2007		1,000		(478,235)
2/5/2007		895		(477,340)
2/5/2007		305		(477,035)
2/9/2007			4,675	(481,710)
2/9/2007		11,925		(469,785)
2/14/2007		2,750		(467,035)
2/14/2007		1,000		(466,035)
2/15/2007		140		(465,895)
2/20/2007		5,000		(460,895)
2/23/2007		3,050		(457,845)
2/23/2007		2,500		(455,345)
3/6/2007		18,000		(437,345)
3/7/2007		12,325		(425,020)
3/9/2007		6,675		(418,345)
3/19/2007		1,500		(416,845)
3/23/2007		1,650		(415,195)
3/29/2007		8,030		(407,165)
4/2/2007		4,650		(402,515)
4/3/2007		2,150		(400,365)
4/4/2007		1,000		(399,365)
4/10/2007			1,500	(400,865)
4/17/2001			1,220	(402,085)
4/17/2007		1,800		(400,285)
5/21/2007		1,000		(399,285)
5/24/2007			2,100	(401,385)
5/24/2007		2,100		(399,285)
Totals		**358,570**	**757,855**	**(399,285)**

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE: DANIEL LEE RITZ, JR., a/k/a BO RITZ **Debtor**	§ § § §	**CASE NO. 09-39895** **CHAPTER 7**
HUSKY INTERNATIONAL ELECTRONICS, INC., **Plaintiff** **vs.** **DANIEL LEE RITZ, JR.,** **Defendant**	§ § § § § § § § §	**ADVERSARY PROCEEDING NO. _____**

PLAINTIFF'S ORIGINAL COMPLAINT TO DENY DISCHARGEABILITY OF DEBT PURSUANT TO 11 U.S.C. §523

Husky International Electronics, Inc., creditor herein (hereinafter "Plaintiff" or "Husky"), files this Complaint to Deny Dischargeability of Debt Pursuant to 11 U.S.C. §523. In support hereof, plaintiff states as follows:

I. JURISDICTION

1. The Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. §157, §1334 and 11 U.S.C. §523. This is a core proceeding under 28 U.S.C. §157(b)(l) and §157(b)(2)(B), (I) and (O). This adversary proceeding is brought in connection

with Defendant's case under Chapter 7 of Title 11 U.S.C., Case No. 09-39895.

II. VENUE

2. Venue is proper under 28 U.S.C. §1409(a).

III. PARTIES

3. Plaintiff Husky International Electronics, Inc., is a Colorado corporation.

4. Defendant Daniel Lee Ritz, Jr., Debtor and Defendant herein ("Debtor" or "Defendant"), is an individual residing in Harris County, Texas, who may be served with the summons and complaint in accordance with Bankruptcy Rule 7004(b)(9) by mailing it to Defendant by U.S. First Class Mail, postage prepaid to the mailing address shown in his petition, 20615 Denford Court, Katy, Texas, 77450. Jeffrey S. Williams is the Debtor's attorney and may be served with a copy of the summons and complaint in accordance with Bankruptcy Rule 7004(b)(9) by U.S. First Class Mail, postage prepaid, at 11200 Westheimer, Suite 900, Houston, Texas 77042.

IV. NATURE OF THE CASE

5. This is an adversary proceeding on plaintiff's fraud claims against the debtor. This suit seeks to reduce the debt to a judgment against debtor and requests a determination that the judgment is a debt that should not be discharged by the Bankruptcy Court pursuant to 11 U.S.C. §523(a)(2), (a)(4) and (a)(6).

V. FACTUAL BACKGROUND

6. Husky is a Colorado seller and distributor of electronic device components. Ritz was a director and owner of the now-defunct Chrysalis

Manufacturing Corporation ("Chrysalis"), a manufacturer of electronic circuit boards and other devices. Chrysalis purchased components from Husky to make the electronic circuit boards and other devices that Chrysalis then sold.

7. Husky and Chrysalis entered into a "Master Credit and Sales Agreement" (the "Master Agreement"). The Master Agreement provided that Husky would deliver merchandise to Chrysalis pursuant to the exchange of purchase orders and confirmations. Pursuant to the Master Agreement, Chrysalis placed numerous orders for components which Husky filled and delivered.

8. However, instead of using the proceeds from the sale of circuit boards and other devices to pay Husky for the components, Ritz caused Chrysalis to dissipate the funds to Ritz's family members and to other companies Ritz owned. Ritz then caused the insolvent Chrysalis to file bankruptcy, as a result of which Chrysalis failed to pay Husky for **$182,433.04** in components.

9. Specifically, between November 2006 and May 2007, Ritz transferred more than **$1,200,000.00** of Chrysalis' cash in *at least* the following individual amounts to the following seven entities and to Ritz's father:

(i) **$677,622.00** to ComCon Manufacturing Services, Inc., a/k/a VirTra Merger Corporation;

(ii) **$121,821.00** to CapNet Securities Corporation;

(iii) **$52,600.00** to CapNet Risk Management, Inc.;

(iv) **$172,100.00** to Institutional Capital Management, Inc., and Institutional Insurance Management, Inc.;

(v) **$99,386.90** to Dynalyst Manufacturing Corporation;

(vi) **$26,500.00** to Clean Fuel International Corp., a/k/a Gulf Coast Fuels, Inc.;

(vii) **$11,240.00** to CapNet Advisors Incorporated; and

(viii) **$60,000.00** to Daniel Lee Ritz, Sr., (Ritz's father).

Ritz was the registered agent for five[1] of the seven entities that reaped the benefits of the monies Ritz transferred, and the registered agent for the remaining two, Leon Andrew Wells, shared Ritz's office address at 2500 City West Blvd., Suite 700, Houston, Texas 77042. Ritz testified on March 27, 2008, that he owned at least the following percentages of the named companies:

(i) CapNet Securities Corporation—**85%**;[2]

(ii) Institutional Capital Management, Inc.—**40%**[3];

(iii) Institutional Insurance Management, Inc.—**100%**;[4]

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[1] Ritz is registered agent for (i) ComCon Manufacturing Services, Inc, a/k/a VirTra Merger Corporation; (ii) CapNet Risk Management, Inc.; (iii) Institutional Capital Management, Inc.; (iv) Institutional Insurance Management, Inc.; and (v) Clean Fuel International Corp.

[2] Ritz deposition of March 27, 2008, 132:23-24.

[3] Ritz deposition of March 27, 2008, 148:1-6.

(iv) Dynalyst Manufacturing Corporation—**25%**;[5] and

(v) Clean Fuel International Corp., a/k/a Gulf Coast Fuels, Inc. —**20%**.[6]

10. Ritz could not remember if he was a stockholder in the remaining companies to which he wired money (because "I've invested in a number of different companies as a stockholder [and] I don't think I could name them all"[7]). However, Ritz did remember that he is also chairman and director of Dynalyst Manufacturing Corporation;[8] president, secretary, treasurer, and director of Institutional Insurance Management, Inc.;[9] director and CEO of Capnet Securities Corporation;[10] a director of Capnet Advisors, incorporated;[11] and a director of CapNet Risk Management, Inc.[12]

11. As a result of Ritz having wired Chrysalis' money to his family members and closely-held companies as detailed above, Chrysalis issued a check dated **November 1, 2006**, with Chrysalis as drawee and Husky as payee in the amount of

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[4] Ritz deposition of March 27,2008, 34:25-35:1.

[5] Ritz deposition of March 27, 2008, 135:1-2.

[6] Ritz deposition of March 27, 2008, 34:23-24.

[7] Ritz deposition of March 27, 2008, 16:14-19.

[8] Ritz deposition of March 27, 2008, 14:17.

[9] Ritz deposition of March 27, 2008, Exhibit 3, p.1.

[10] Ritz deposition of March 27, 2008, 29:19-21 and Exhibit 3, p.1.

[11] Ritz deposition of March 27, 2008, Exhibit 3, p.2.

[12] Ritz deposition of March 27, 2008, Exhibit 3, p.2.

$10,505.25. This check was returned "NSF" when presented by Husky for payment. On **November 14, 2006**, Chrysalis issued a check to Chrysalis as drawee and Husky as payee in the amount of **$14,025.00**. This check was returned NSF when presented by Husky for payment. On **December 19, 2006**, Chrysalis issued a check in the amount of **$23,559.48**. This check was returned "NSF" when presented by Husky for payment. On **December 22, 2006**, Chrysalis issued a check in the amount of **$40,000.00**. Like the others, this check was returned "NSF" when presented by Husky for payment.

VI. CAUSES OF ACTION

A. First Cause of Action-Ritz's Statutory Liability for Chrysalis' Breach of Contract

12. Plaintiff incorporates by reference paragraphs 6-11 above, as if fully set forth below.

13. Ritz used Chrysalis to perpetrate an actual fraud on Husky primarily for his direct personal benefit. Therefore, Ritz is personally liable for Chrysalis' breach of contract. TEX. BUS. ORG. CODE §21.223(b) (formerly TEX. BUS. CORP ACT §2.21); ***Willis v. Donnelly***, 199 S.W.2d 262, 272 (Tex. 2006); *see also* ***PHC-Minden, L.P. v. Kimberly-Clark Corp.***, 235 S.W.3d 163, 173 (Tex. 2007). Thus, an obligee such as Husky may hold a corporate shareholder individually liable for the corporation's contractual obligations. *Id.*

14. Ritz's failure to pay caused damages to Husky for which it here sues. Husky is entitled to reasonable attorney's fees incurred to assert its claims in this suit pursuant to TEX. CIV. PRAC. &

REM. CODE §38.001, *et seq.*, for which Husky also here sues. Husky is also entitled to late charges, interest, statutory penalties, and other damages recoverable at law or in equity, for which Husky also here sues.

B. Second Cause of Action-Common-Law Fraud

15. Plaintiff incorporates by reference paragraphs 6-11 above, as if fully set forth below.

16. By the various actions specified taken on the dates shown above, Ritz used Chrysalis to perpetrate a fraud on Husky, creating the impression that Husky would be paid for its goods while instead dissipating and transferring the money that could have paid for the goods to Ritz's closely-held companies and family members. Ritz's representations to Husky were material because they induced Husky to enter into—and continue—a business relationship which brought Husky to the brink of financial ruin. Ritz did not have the present intention that Chrysalis perform when Ritz used Chrysalis to induce Husky to sell goods. Ritz knew the representations were false or made said false representations recklessly, as a positive assertion, and without knowledge of their truth. Ritz intended for Husky to rely on the false representations. Husky justifiably relied on the false representations when it provided the goods to Chrysalis.

17. Ritz's frauds directly and proximately caused injury to Husky, for which Husky here sues. Because Husky's injury resulted from Ritz's actual fraud or malice, Husky is entitled to exemplary damages

under TEX. CIV PRAC. & REM. CODE § 41.003(a), for which Husky here also sues.

C. Third Cause of Action-Equitable Recovery in Quantum Meruit

18. Plaintiff incorporates by reference paragraphs 6-11 above, as if fully set forth below.

19. Husky provided Ritz (through Chrysalis) with valuable goods totaling **$182,433.04**. Plaintiff provided the goods for Chrysalis' benefit. Chrysalis accepted and used the goods. Ritz knew or should have known that Husky expected compensation because Ritz had reasonable notice that Husky expected compensation when Chrysalis accepted the goods. Chrysalis' acceptance of the goods without payment caused damages for which Husky here sues.

D. Fourth Cause of Action-Breach of Fiduciary Duty

20. Plaintiff incorporates by reference paragraphs 6-11 above, as if fully set forth below.

21. Chrysalis was insolvent, as evidenced by the numerous checks it sent to Plaintiff that were returned "NSF" and that Chrysalis shortly thereafter filed for bankruptcy. When a corporation is insolvent, a fiduciary relationship arises between officers and directors of the corporation and its creditors, and creditors may challenge a breach of the duty. ***Dyer v. Shafer, Gilliland, Davis, McCollum & Ashley, Inc.***, 779 S.W.2d 474, 477 (Tex. App.—El Paso 1989, writ denied); ***Martin v. Kagan (In re Tufts Elecs., Inc.)***, 746 F.2d 915, 917 (1st Cir. 1984). Officers and directors of an insolvent corporation have a fiduciary duty to deal fairly with the corporation's creditors, and that duty includes

preserving the value of the corporate assets to pay corporate debts without preferring one creditor over another or preferring themselves to the injury of other creditors. *See* ***Tigrett v. Pointer***, 580 S.W.2d 375, 383-85 (Tex. Civ. App.—Dallas 1978, writ ref'd n.r.e.).

22. As an officer and director of the insolvent Chrysalis, Ritz owed Husky a fiduciary duty to preserve Chrysalis' assets to pay its creditors fairly. In such a fiduciary relationship, Ritz was bound to act in good faith and with due regard to Husky's interests. ***Judwin Props., Inc. v. Griggs & Harrison***, 911 S.W.2d 498, 506 (Tex. App.-Houston [1st Dist.] 1995, no writ). In addition, fiduciaries owe their beneficiaries (i) a duty of candor; (ii) a duty to refrain from self-dealing; (iii) a duty to act with integrity of the strictest kind; (iv) a duty of fair, honest dealing; and (v) a duty of full disclosure.

23. Ritz, by his various defalcations, self-dealing, dishonesty, and preferring other creditors over Husky, breached his fiduciary duties to Husky. Ritz's breaches of fiduciary duty resulted in both injury to Husky and personal benefit to Ritz. As a result, Husky is entitled to, and here sues for, (i) out-of-pocket losses and expenses, (ii) lost profits, (iii) exemplary damages in an amount not less than $400,000.00, (iv) an accounting, and (v) appointment of a receiver.

VII. EXCEPTION TO DISCHARGE FOR DEBTS FOR FRAUD AND BREACH OF FIDUCIARY DUTY

24. A debt for money or property obtained by fraud is an exception to discharge under 11 U.S.C.

§523(a)(2). A debt for fraud or defalcation while acting in a fiduciary capacity is an exception to discharge under 11 U.S.C. §523(a)(4). An award of exemplary damages for Ritz's willfully and maliciously injury through her fraud will be a debt for willful or malicious injury and an exception to discharge under 11 U.S.C. §523(a)(6).

VIII. JURY DEMAND

25. Plaintiff requests a jury trial of his claims.

IX. PRAYER

26. For these reasons, Plaintiff prays that summons be issued for Defendant to appear and answer, and that Husky be awarded judgment against Defendant for the following:

(i) Actual damages;

(ii) Avoidance of all fraudulent transfers to the extent necessary to satisfy Plaintiffs claims;

(iii) Exemplary damages;

(iv) Prejudgment and postjudgment interest at the maximum lawful rate;

(v) Attorney's fees;

(vi) Court costs; and

(vii)All other relief to which Plaintiff shall show itself to be justly entitled;

together with a determination that the judgment entered may not be discharged by Defendant's bankruptcy pursuant to 11 U.S.C. §523(a).

Respectfully submitted,

ESCAMILLA, PONECK & CRUZ, LLP

By: /s/ Jeffrey L. Dorrell

Jeffrey L. Dorrell
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Federal I.D. 18465
201 Stratford
Houston, Texas 77006-3219
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jdorrell@epc-law.com
ATTORNEYS FOR PLAINTIFF

UNITED STATES BANKRUPTCY COURT FOR THE SOUTHERN DISTRICT OF TEXAS HOUSTON DIVISION

IN RE:	§	
	§	CASE NO. 09-39895
DANIEL LEE RITZ, JR.	§	
	§	CHAPTER 7
DEBTOR(S).	§	
	§	
	§	
HUSKY INTERNATIONAL ELECTRONICS, INC.,	§	
	§	
	§	
PLAINTIFF(S),	§	
	§	ADVERSARY NO. 10-03156
V.	§	
	§	
DANIEL LEE RITZ, JR.,	§	
	§	
DEFENDANT(S).	§	

TO THE HONORABLE UNITED STATES BANKRUPTCY JUDGE:

Defendant, Daniel Lee Ritz, Jr. ("Ritz"), responds to the third party complaint filed by Plaintiff, Husky International Electronics, Inc. ("Husky") as follows:

RESPONSES TO ALLEGATIONS BY PARAGRAPH

1. Ritz admits the allegations contained in this paragraph.

2. Ritz admits the allegations contained in this paragraph.

3. Ritz has insufficient knowledge to admit or deny the allegations contained in this paragraph.

4. Ritz responds as follows to the allegations in this paragraph:

a. **1st Sentence Only**. Ritz admits the allegations contained in this sentence.

b. **2nd Sentence Only**. Ritz denies the allegations contained in this sentence. Mr. Williams is Mr. Ritz' attorney in connection with the main case (09-39895), but was not retained, and is not acting as counsel in connection with this adversary proceeding. Ritz and Mr. Williams view as this adversary proceeding as a separate and distinct legal proceeding from the main case.

5. Ritz admits the allegations contained in this paragraph; i.e. that this lawsuit is based in part upon Husky's allegation that Ritz committed fraud. Ritz denies that he actually com- mitted any fraud.

6. Ritz responds as follows to the allegations in this paragraph:

a. **1st Sentence Only**. Ritz admits the allegations contained in this sentence.

b. **2nd Sentence Only**. Ritz admits that he was a director and owner of approximately 30% of Chrysalis common stock, and that Chrysalis was a manufacturer of electronic circuit boards and other devices. Ritz denies that he was the sole or majority owner of Chrysalis common stock.

c. **3RD Sentence Only**. Ritz admits that Chrysalis purchased parts from Husky, and that the material would have been purchased for the purpose of manufacturing devices made by Chrysalis. Ritz has insufficient knowledge to admit or deny whether the parts were

"components" or whether the parts were in fact used to manufacture electronic circuit boards or other devices made by Chrysalis.

7. Ritz responds as follows to the allegations in this paragraph:

a. 1st Sentence Only. Ritz admits the allegations contained in this paragraph.

b. 2nd Sentence Only. Ritz has insufficient knowledge to admit or deny whether the Master Agreement contains the provisions alleged. The copy of the Mater Agreement in Ritz' possession is illegible and virtually unreadable.

c. 3rd Sentence Only. Ritz admits that Chrysalis made periodic purchases of parts from Husky. Ritz has insufficient knowledge to admit or deny whether the purchases were made pursuant to the Master Agreement, or whether the Master Agreement was still in effect.

8. Ritz admits that Chrysalis filed for bankruptcy on 6/12/08. Ritz denies the remaining allegations contained in this paragraph.

9. Ritz responds as follows to the allegations in this paragraph:

a. 1st Sentence Only (including (i) - (viii)). Ritz has insufficient knowledge to admit or deny the allegations of this paragraph. Therefore, these allegations are denied.

b. 2nd Sentence Only.

i. Ritz admits that:

(1) he was the registered agent for:

(a) ComCon Manufacturing Services, Inc, a/k/a VirTra Merger Corporation;

(b) CapNet Risk Management, Inc.;

(c) Institutional Capital Management, Inc.;

(d) Institutional Insurance Management, Inc.; and

(e) Clean Fuel International Corp.

(2) Leon Andrew Wells was the registered agent for Dynalyst Manufacturing Corporation and CapNet Advisors Incorporated, and that Mr. Wells also had an office at 2500 City West Blvd., Suite 700, Houston, Texas 77042.

ii. Ritz denies that he transferred any monies or that any entities that may have received payments from Chrysalis "reaped the benefits."

c. **3rd Sentence Only**. Ritz denies the allegations contained in this sentence and would further respond as follows:

i. **CapNet Securities Corporation** - Ritz testified that he believed that he owned 85 percent, not that he owned "at least" 85 percent.

ii. **Institutional Capital Management, Inc.** - Ritz testified that he owned "About 40 percent", not "at least" 40 percent.

iii. **Institutional Insurance Management, Inc.** Ritz testified that "I own 100 percent of that", not "at least" 100 percent.

iv. **Dynalyst Manufacturing Corporation** Ritz testified that he owned "Approximately 25 percent", not "at least" 25 percent.

v. **Clean Fuel International Corp.** Ritz testified that he owned "Approximately 20 percent", not "at least" 20 percent.

10. Ritz responds as follows to the allegations in this paragraph:

a. 1st Sentence Only. Ritz denies the allegations of this sentence. This allegation is vague and ambiguous, and mischaracteriszes the testimony.

b. 2nd Sentence Only. Ritz admits the allegations of this sentence as they pertain to Dynalyst Manufacturing Corporation. Ritz has insufficient knowledge to admit or deny the allegations of this sentence.

11. Ritz responds as follows to the allegations in this paragraph:.

a. 1st Sentence Only. Ritz admits that Chrysalis issued a check dated November 1, 2006, with Chrysalis as drawee and Husky as payee in the amount of $10,505.25. Ritz denies the remaining portions of this sentence.

b. 2nd Sentence Only. Ritz admits the allegations contained in this sentence.

c. 3rd Sentence Only. Ritz has insufficient knowledge to admit or deny (and therefore denies) the allegations of this sentence with respect to the date that the check was issued. Ritz admits the remaining allegations contained in this sentence.

d. 4th Sentence Only. Ritz admits the allegations contained in this sentence.

e. 5th Sentence Only. Ritz has insufficient knowledge to admit or deny (and there- fore denies) the allegations of this sentence with respect to the date that the check was issued. Ritz admits the allegations contained in this sentence.

f. 6th Sentence Only. Ritz admits the allegations contained in this sentence.

g. 7th Sentence Only. Ritz has insufficient knowledge to admit or deny (and there- fore denies) the allegations of this sentence with respect to the date that the check was issued. Ritz admits the allegations contained in this sentence.

h. 8th Sentence Only. Ritz admits the allegations contained in this sentence.

12. Ritz incorporates the responses the paragraphs 6 through 11 above, as if fully set forth below.

13. Ritz denies the allegations contained in this paragraph.

14. Ritz denies the allegations contained in this paragraph.

15. Ritz incorporates the responses the paragraphs 6 through 15 above, as if fully set forth below.

16. Ritz denies the allegations contained in this paragraph.

17. Ritz denies the allegations contained in this paragraph.

18. Ritz incorporates the responses the paragraphs 6 through 17 above, as if fully set forth below.

19. Ritz responds as follows to the allegations in this paragraph:

a. 1st Sentence Only. Ritz denies the allegations contained in this sentence.

b. 2nd sentence Only. Ritz admits that Husky regularly and periodically sold parts to Chrysalis. Ritz denies that Husky provided "the goods" for Chrysalis' benefit. The phrase "the goods" is vague and ambiguous because Husky does not define or itemize the goods to which it refers.

c. 3rd Sentence Only. Ritz denies the allegations contained in this sentence.

d. 4th Sentence Only. Ritz denies the allegations contained in this sentence.

20. Ritz incorporates the responses the paragraphs 6 through 19 above, as if fully set forth below.

21. Ritz denies the allegations contained in this paragraph.

22. Ritz denies the allegations contained in this paragraph.

23. Ritz denies the allegations contained in this paragraph.

24. Ritz responds as follows to the allegations in this paragraph:

a. 1st and 2nd Sentences Only. Ritz admits the allegations contained in this sentence.

b. 3rd Sentence Only. Ritz denies the allegations contained in this sentence.

25. Ritz denies that Husky is entitled to a jury trial, and requests the Court to strike Husky's request for a jury trial.

26. Ritz denies that Husky is entitled to any of the relief specified in this paragraph.

DEFENSES

27. There is a defect in the parties. Ritz is not liable in the capacity in which he has been sued. All actions taken by Ritz with respect all of the transactions and occurrences involved in this lawsuit were taken only as an authorized agent for Chrysalis

Chrysalis did not undertake any actions as a principal party.

PRAYER

28. Ritz respectfully requests the Court to enter judgment that:

a. Husky take nothing;

b. Ritz be discharged with his costs; and

c. Ritz be awarded such other and further relief which is just and fair.

Respectfully Submitted,

By: /s/ Daniel Lee Ritz, Jr.

Daniel Lee Ritz, Jr.
738 Highway 6 South, Suite 230
Houston TX 77079

ATTORNEY IN CHARGE FOR:

713-269-4969 **Cell**
281-493-3849 X7794 Office

832-596-7764 **Direct Line**
281-293-8095 **Fax**
bor@capnetcapitalpartners.com - **E-Mail**

PRO SE

CERTIFICATE OF SERVICE

I certify that on the following date, a true and correct copy of the forgoing document was forwarded to the persons and by the method described below.

Date of Service: May 20, 2010

Method of Service: See below

Person Served:

Husky International Electronics, Inc.
c/o Jeffery Lee Dorrell
jdorrell@escamillaponeck.com (ECF)
squerales@escamillaponeck. com (ECF)

Jeffrey S Williams
jswilliams100@earthlink.net (ECF)

/s/ Daniel Lee Ritz, Jr.
Daniel Lee Ritz

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE: DANIEL LEE RITZ, JR., a/k/a BO RITZ **Debtor,**	§ § § §	**CASE NO. 09-39895** **CHAPTER 7**
HUSKY INTERNATIONAL ELECTRONICS, INC., **Plaintiff** **vs.** **DANIEL LEE RITZ, JR.,** **Defendant**	§ § § § § § § § §	**ADVERSARY PROCEEDING NO. 10-03156**

JOINT PRETRIAL STATEMENT

I. STATEMENT OF THE ADVERSARY PROCEEDING

Plaintiff's Statement:

Plaintiff Husky International Electronics, Inc., contends that defendant Daniel Lee Ritz, Jr., a natural person, is individually liable for the contractual obligations of Chrysalis Manufacturing Corporation—a company of which Ritz was an officer, director, and stockholder. Chrysalis filed for bankruptcy protection on June 12, 2008, owing Husky **$163,999.38** for various electronic components purchased. The basis of Ritz's alleged personal liability is his allegedly fraudulent transfers of approximately $1.2 million of Chrysalis' cash to other

entities Ritz owned or controlled during a 6-month period during which Chrysalis was not paying Husky for the product Husky sold and delivered to Chrysalis.

Defendant's Statement:

Plaintiff asserts that Defendant is guilty of fraud and breach of fiduciary duty, that Plaintiff has suffered damages as a result of Defendant's conduct, and that Plaintiffs has actual suffered damages. Plaintiff asserts that the damages suffered by Plaintiff are non-dischargeable pursuant to 11 U.S.C. §523(a)(2), (a)(4) and (a)(6).

II. JURISDICTION

There are no jurisdictional questions. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2).

III. PENDING MOTIONS

1. Plaintiff's motion to exclude evidence and to reopen discovery.

IV. CONTENTIONS OF THE PARTIES

Plaintiff's Contentions:

Husky contends that defendant Ritz is individually liable for the **$163,999.38** in contractual obligations of Chrysalis Manufacturing Corp. (plus attorney's fees) to plaintiff Husky on the following grounds:

(i) As a Chrysalis shareholder, Ritz can be held liable for the **$163,999.38** in contractual obligations of Chrysalis if Ritz caused Chrysalis to be used for the purpose of perpetrating and did perpetrate an actual fraud on Husky for Ritz's direct personal benefit. TEX. BUS. ORG. CODE §21.223(b). Chrysalis' fraudulent transfer of some or all of

the approximately $1.2 million transferred to other Ritz corporations in 2006 and 2007 was in actual fraud against the rights of Husky and personally benefitted Ritz.

(ii) As an officer and director of Chrysalis, defendant Ritz had a fiduciary duty to plaintiff Husky (and other Chrysalis creditors) once Chrysalis became insolvent. Chrysalis' fraudulent transfers totaling approximately $1.2 million to other Ritz corporations and Ritz's father instead of paying the **$163,999.38** owed to Husky was a breach of that fiduciary duty for which Ritz is individually liable.

(iii) A fiduciary duty is owed by the officers and directors of an insolvent corporation to the corporation's creditors—and a cause of action for breach of such a fiduciary duty will lie—despite the enactment of TEX. BUS. ORG. CODE §21.223(b) in 1999.

(iv) Attorney's fees are recoverable in a bankruptcy adversary proceeding.

(v) Claims arising from fraud and breach of fiduciary duty are nondischargeable in bankruptcy under Bankruptcy Code §523.

Defendant's Contentions:

Defendant contends that:

Fraud.

1. He did not participate in, authorize or have any knowledge of the bad checks issued to Plaintiff.

2. He did not engage in any conduct that would constitute fraud.
3. He did not benefit from any conduct that Plaintiff alleges he has committed.
4. Plaintiff's fraud claims are limited to the statutory fraud claims alleged pursuant to Tex. Bus. Org. Code §21.223(b). All claims based on breach of contract, quantum meruit, common law fraud and breach of fiduciary duty have been displaced by § 21.223(a)(2). The limitation of liability specified in Tex. Bus. Org. Code § 21.223(a)(2) has been applied to persons who are shareholders while simultaneously acting as a director. *See*, *Willis v. Donnelly*, 199 S.W.3d 262, 265 (Tex. 2006), which held that Tex. Bus. Org. Code § 21.223(a)(2) prevented the use of the common law theory of breach of fiduciary against a defendant who was simultaneously both a shareholder and served as a director of the corporate entity.

Quantum Meruit. Plaintiff is not entitled to recover under any theory of quantum meruit. Defendant is not personally liable under this theory because:

1. All goods provided by Plaintiff were ordered, obtained and used by Chrysalis, not Defendant.
2. Defendant did not gain any personal benefit from the goods provided by Plaintiff.

Breach of Fiduciary Duty. Defendant did not commit any breach of fiduciary duty because:

1. As a matter of law, as a result of Tex. Bus. Org. Code § 21.223(a)(2) and (b), Plaintiff's breach of fiduciary duty claims have no application.
2. The Texas Supreme Court opinion issued in *Willis v. Donnelly*, 199 S.W.3d 262, 265 (Tex. 2006), has held that Tex. Bus. Org. Code § 21.223(a)(2) prevents the use of the common law theory of breach of fiduciary against a defendant who is both a shareholder and serves as a director of the corporate entity.
3. Even if breach of fiduciary duty is available as a legal theory, Plaintiff suffered no damages.

Punitive Damages. Defendant is not entitled to recover punitive damages because Plaintiff has not plead, and Defendant has not committed, any intentional, willful or malicious conduct that would permit Plaintiff to recover punitive damages.

Attorney's Fees. Plaintiff may not recover attorney's fees because attorney fees are only recoverable under claims couched under a legal theory based upon breach of contract. The contract claims asserted by Plaintiff, even if viable and applicable to Defendant, are not rendered non-dischargeable by BC § 523.

V. ADMISSIONS OF FACT

1. Defendant Daniel Lee "Bo" Ritz, Jr., is a natural person residing in Houston, Harris County, Texas. (Ritz's November 26, 2010, Admission of Fact No. 1.)

2. At all relevant times, Altatron EMS was an assumed name of Chrysalis Manufacturing Corp., and the two entities are the same.
3. At all relevant times, Ritz was a director of Chrysalis.
4. At all relevant times, Ritz owned approximately 30% of Chrysalis' common stock.
5. Chrysalis was a manufacturer of electronic circuit boards and other devices. (Ritz's November 26, 2010, Admission of Fact No. 4.)
6. Husky and Chrysalis entered into a Master Credit and Sales Agreement dated December 17 2003, pursuant to which Chrysalis periodically purchased parts from Husky until 2006. (Ritz's answers to R/A 16 and 18; Ritz's November 26, 2010, Admission of Fact No. 5 and 7.)
7. Chrysalis received the goods described in plaintiff Husky's complaint as having been sold and delivered by Husky. (Ritz's answer to R/A 11.)
8. All goods provided by Husky were ordered, obtained, and used by Chrysalis, not Ritz.
9. Between November 2006 and May 2007, Ritz caused **$172,100.00** to be transferred from Chrysalis to Institutional Insurance Management, Inc. (Ritz's answer to R/A 5.)
10. At all relevant times, Ritz owned **100%** of Institutional Insurance Management, Inc. (Ritz's admission in answer to Husky's complaint.)

11. Between November 2006 and May 2007, Ritz caused **$121,821.00** to be transferred from Chrysalis to CapNet Securities Corporation. (Ritz's answer to R/A 3.)

12. At all relevant times, Ritz owned approximately **85%** of CapNet Securities Corporation. (Ritz's admission in answer to Husky's complaint.)

13. Between November 2006 and May 2007, Ritz caused **$11,240.00** to be transferred from Chrysalis to CapNet Advisors, Incorporated. (Ritz's answer to R/A 9.)

14. Chrysalis issued Check No. 1993 in the amount of **$18,433.66** dated October 31, 2006, payable to Husky which was returned "NSF." (Ritz's November 26, 2010, Admission of Fact No. 9.)

15. Chrysalis issued a check in the amount of **$10,505.25** dated November 1, 2006, payable to Husky which was returned "NSF." (Ritz's November 26, 2010, Admission of Fact No. 9.)

16. Chrysalis issued a check in the amount of **$14,025.00** dated November 14, 2006, payable to Husky which was returned "NSF." (Ritz's November 26, 2010, Admission of Fact No. 9.)

17. Chrysalis issued a check in the amount of **$23,559.48** dated December 19, 2006, payable to Husky which was returned "NSF." (Ritz's November 26, 2010, Admission of Fact No. 9.)

18. Chrysalis issued a check in the amount of **$40,000.00** dated December 22, 2006, payable

to Husky which was returned "NSF" (Ritz's November 26, 2010, Admission of Fact No. 9.)

19. Chrysalis filed for bankruptcy on June 12, 2008. (Ritz's November 26, 2010. Admission of Fact No. 8.)

VI. CONTESTED ISSUES OF FACT

Plaintiff's Contested Issues of Fact:

1. The dollar amount of goods Chrysalis received from plaintiff Husky but for which Chrysalis never paid.
2. Whether Ritz used Chrysalis to perpetrate an actual fraud on Husky for Ritz's direct personal benefit.
3. Whether defendant Ritz was in financial control of Chrysalis.
4. Whether the transfers of $1.2 million of Chrysalis funds to defendant Ritz's other companies in a 6-month period in 2006 and 2007 (while Chrysalis owed **$163,999.38** to plaintiff Husky) were fraudulent as to the rights of Husky.
5. Whether Chrysalis was insolvent at the time the transfers were made.

Defendant's Contested Issues of Fact:

The contested issues of fact, as understood by Defendant, are as follows:

Statutory Liability - Actual Fraud. Whether Defendant: **(1)** committed an actual fraud on Plaintiff; and **(2)** directly and personally benefitted from any such conduct.

Breach of Fiduciary Duty. Whether: **(1)** Chrysalis was insolvent; **(2)** if Chrysalis was insolvent, the point in time at which the insolvency arose; **(3)** Defendant had a fiduciary duty towards Plaintiff; and **(4)** Plaintiff suffered any damages.

Punitive Damages. Whether Defendant engaged in any intentional, willful and/or malicious conduct that would warrant the imposition of punitive damages.

VII. AGREED APPLICABLE PROPOSITIONS OF LAW

1. A shareholder of a corporation can be held liable for the contractual obligations of the corporation if the shareholder caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on another for the shareholder's direct personal benefit. TEX. BUS. ORG. CODE §21.223(b).

VIII. CONTESTED ISSUES OF LAW

Plaintiff's Contested Issues of Law:

1. Whether Ritz should be permitted to use documents or evidence not disclosed in compliance with FED. R. CIV P 26(a).

2. Whether a fraudulent transfer of funds to a corporate entity can be a "direct personal benefit" to an owner of all or part of that entity within the meaning of TEX. BUS. ORG. CODE §21.223(b).

3. Whether a fiduciary duty exists from the officers and directors of an insolvent corporation to the corporation's creditors.

4. Whether a plaintiff in a bankruptcy adversary proceeding may recover attorney's fees from the defendant.

Defendant's Contested Issues of Law:

1. Whether Plaintiff's fraud and breach of fiduciary duty claims have been legally displaced by Tex. Bus. Org. Code § 21.223(a)(2), and limited to the statutory fraud claims specified in Tex. Bus. Org. Code § 21.223(b).
2. Whether the legal theory of quantum meruit can be used to impose personal liability upon Defendant for the goods sold by Plaintiff to Chrysalis.
3. Whether Plaintiff is entitled to recover attorney fees in a dischargeability suit filed pursuant to BC § 523.

IX. EXHIBITS

Plaintiff: One set of Husky's trial exhibits in the required 3-ring notebook was transmitted to a courier for delivery to chambers no later than 9:00 AM January 24, 2011.

Defendant: Defendant's Exhibit List is attached hereto.

X. WITNESSES

Plaintiff's Witnesses

1. Mr. Nick Davis

   Husky International Electronics, Inc.

   6725 Powell Street

   Loveland, Colorado 80538\

   Estimated Time for Direct Examination:

   2 Hours.

Davis, president of Husky, will testify to the business relationship between Husky and Chrysalis; the dollar amount of product sold and delivered by Husky to Chrysalis for which Chrysalis did not pay; the settlement of Husky's claims which Chrysalis did not perform; and may relate these facts to other facts established by any admitted exhibits for context and clarity.

2. Mr. Mike Bernard

   Husky International Electronics, Inc.

   6725 Powell Street

   Loveland, Colorado 80538

   Estimated Time for Direct Examination:

   1 Hour.

   Husky's vice president of operations will testify to the business relationship between Husky and Chrysalis; the dollar amount of product sold and delivered by Husky to Chrysalis for which Chrysalis did not pay; and the settlement of Husky's claims which Chrysalis did not perform.

3. Mr. Daniel Lee "Bo" Ritz, Jr.

   15721 Park Row, Suite 100

   Houston, Texas 77084

   Estimated Time for Direct Examination:

   4 Hours.

   Defendant Ritz will be called to testify by both deposition and live regarding all matters in controversy in the case.

4. Ms. Nancy Finney, CPA

   565 South Mason Road

   Katy, Texas 77450

   Estimated Time for Direct Examination:

   .50 Hours.

   Finney, former controller and CPA for Chrysalis, will testify to her job responsibilities of moving money from entity to entity in the "Ritz Empire" of companies; that defendant Ritz was always in complete financial control of Chrysalis; and that Ritz directly benefited from monies transmitted from Chrysalis to Institutional Insurance Management because Ritz "lived off of" Institutional Insurance Management.

5. Mr. James David Rogers

   9322 Fairdale Lane

   Houston, Texas 77063

   Estimated Time for Direct Examination:

   .50 Hours.

   Rogers, former CFO and vice president of several of the "Ritz Empire" of companies, will testify that defendant Ritz took no salaries from the companies in the "Ritz Empire" because he "did not like to pay taxes;" instead Ritz took "loans" from his companies, which were periodically forgiven; this was a direct benefit to Ritz enabled by the transfers of cash from Chrysalis to Institutional Insurance Management and others.

6. Mr. Richard Lynn Hollan

1519 Emerald Green Boulevard

Houston, Texas 77094

Estimated Time for Direct Examination:

2.00 Hours.

Hollan, former business associate of defendant Ritz, is expected to testify that Ritz was in absolute financial control of Chrysalis, and misappropriated Chrysalis funds for himself using the conduits of other Ritz companies.

7 Mr. Bob Leahy

70 Hillover Lane

Sag Harbor, New York

1196302328 Estimated Time for

Direct Examination: .50 Hours.

Leahy, former officer of Chrysalis, is expected to testify that he did not order or participate in any transfers of cash from Chrysalis to other Ritz entities, and that all such transfers were directed by Ritz.

8. Mr. Marlin Williford

20019 Sky Hollow Lane

Katy, Texas 77450

Estimated Time for Direct Examination:

.20 Hours.

Williford will testify that Ritz was always in complete financial control of Chrysalis.

9. Mr. James B. McElravy, CPA

8820 Will Clayton Parkway, Suite G

Humble, Texas 77338

Estimated Time for Direct Examination:

.20 Hours.

McElravy will testify that Ritz was always in complete financial control of Chrysalis.

10. Ms. Carrie Cogburn

Vice President and Assistant General Counsel

Amegy Bank

P.O. Box 27459

Houston, Texas 77227-7459

Estimated Time for Direct Examination:

3.00 Hours.

The witness will testify as custodian of records for Amegy Bank if Ritz does not stipulate to admissibility of the bank statements he produced.

11. Rene Gomez

Custodian of Records,

Prosperity Bank

777 Walker, Suite 140L

Houston, Texas 77002

Estimated Time for Direct Examination:

.50 Hours.

The witness will testify as custodian of records for Prosperity Bank if Ritz does not stipulate to admissibility of the bank statements he produced.

Defendant's Witnesses

See the attached "Defendant's First Amended Witness List (Trial)."

XI. SETTLEMENT

Prospects for settlement do not appear good.

XII. ESTIMATED TRIAL TIME

Plaintiff: Plaintiff Husky estimates four and one-half days for trial.

Defendant: Defendant estimates the time required for trial will be approximately 12 to 16 hours.

XIII. ATTACHMENTS

Include the following REQUIRED attachments FOR EACH PARTY:

a. Proposed findings of fact and conclusions of law, with supporting authorities in a memorandum of law;

b. Exhibit Lists (2 copies);

c. Objections to Exhibits (2 copies); and

d. Witness Lists (2 copies).

By our signatures below, each of us understands that failure to adhere to the Court's requirements relating to the Joint Pretrial Statement may result in sanctions being imposed.

ESCAMILLA, PONECK & CRUZ, LLP

By: /s/ Jeffrey L. Dorrell

Jeffrey L. Dorrell

State Bar No. 00787386

Federal I.D. 18465

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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE: DANIEL LEE RITZ, JR., a/k/a BO RITZ **Debtor**	§ § § §	**CASE NO. 09-39895** **CHAPTER 7**
HUSKY INTERNATIONAL ELECTRONICS, INC., **Plaintiff** **vs.** **DANIEL LEE RITZ, JR.,** **Defendant**	§ § § § § § § § §	**ADVERSARY PROCEEDING NO. 10-03156**

PLAINTIFF HUSKY INTERNATIONAL ELECTRONICS, INC.'S MEMORANDUM OF LAW ON CONTESTED LEGAL ISSUES

* * *

[Page 4]

Issue 2: Whether a Fraudulent Transfer of Funds to a Corporate Entity Can Be a "Direct Personal Benefit" to an Owner of All or Part of That Entity Within the Meaning of TEX. BUS. ORG. CODE §21.223(b)

7 Individual shareholders cannot be held liable for corporate debts except in narrowly prescribed circumstances. ***Willis v. Donnelly***, 199 S.W.3d 262, 271-72 (Tex. 2006); see TEX. BUS. ORGS. CODE § 21.223(a) (previously codified at TEX. BUS. CORP. ACT art. 2.21(A). Liability of a shareholder under section

21.223 is exclusive and preempts any other liability imposed for that obligation under common law or otherwise." *Id.* § 21.224. The only exception to this rule pertinent in the case at bar is where the shareholder "caused the corporation to be used for the purpose of perpetuating and did perpetuate an actual fraud on the obligee primarily for the direct personal benefit of the shareholder." *Id.* §21.223(b).

8. Courts have often had to decide whether an alleged benefit is a "direct personal benefit" allowing imposition of personal liability upon a shareholder under the exception of §21.223(b). These have included the fraudulent transfer of assets to a corporation owned 100% by the individual defendant, as occurred in the case at bar. ***Nick Corp. v. JNS Aviation, Inc. (In re JNS Aviation, LLC)***, 376 B.R. 500 (Bankr. W.D. Tex., 2008). They have also included direct ownership and/or financial interest in various corporate entities that received diverted sums due to another undercapitalized entity. ***McCarthy v. Wani Venture, A.S.***, 251 S.W.3d 573, (Tex. App.—Houston [1st Dist.] 2007, pet denied). "Any benefit" bestowed on the company is a personal benefit to the majority owner and controller. ***David W. Morrison W. Builders of Amarillo, Inc. v. Morrison (In re David W. Morrison W. Builders of Amarillo, Inc.)***, 361 B.R. 107, 2007 Bankr. LEXIS 342 (Bankr. W.D. Tex., 2007) (applying article 2.21(A)(2) and concluding that majority stockholder received direct personal benefit). At least one court found a direct personal benefit justifying imposition of personal liability when oil well operating expenses were reallocated to oil wells in which defendant shareholder "owned a small percentage," thereby

reducing his level of expenses. ***Cass v. Stephens***, 156 S.W.3d 38, 60 (Tex. App.—El Paso 2004, pet. denied).

9. Despite the statute's use of the phrase "direct personal benefit," it is not necessary that Ritz have transferred Chrysalis money to himself or purchased assets for his own use for Ritz to have perpetrated a fraud on Husky for his "direct personal benefit."

Issue 3: Whether a Fiduciary Duty Exists From the Officers and Directors of an Insolvent Corporation to the Corporation's Creditors

10. As a general rule, corporate officers and directors owe fiduciary duties only to the corporation and not to the corporation's creditors, unless there has been prejudice to the creditors. *See* ***Martin v. Kagan (In re Tufts Elecs., Inc.)***, 746 F.2d 915, 917 (1st Cir. 1984). However, when a corporation is insolvent, a fiduciary relationship arises between the officers and directors of the corporation and its creditors, and creditors may challenge a breach of the duty. *See id.*; ***Dyer v. Shafer, Gilliland, Davis, McCollum & Ashley, Inc.***, 779 S.W.2d

* * *

4:11-CV-3020

IN THE

UNITED STATES DISTRICT COURT

For the Southern District of Texas

Sitting at Houston

In re

DANIEL LEE RITZ, JR.,

Debtor-Appellee

U.S. Bankruptcy Court Case No. 09-39895-H4-7; Adversary No. 10-03156

Appeal From August 4, 2011, Judgment Relating to Complaint to Deny Dischargeability Entered by Hon. Jeff Bohm, U.S. Bankruptcy Court

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APPELLANT'S REPLY BRIEF

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* * *

[Page 10]

E. Ritz's Debt to Husky is Nondischargeable Under § 523(a)(2) Because Ritz Obtained Husky's Property By Fraudulent Transfer to Himself

It is difficult to determine precisely what Ritz's argument is on this point, but Ritz captions his argument with this:

5. Husky's § 523(a)(2) claim fail fails (sic) as a matter of law because the property obtained by *Chrysalis* was not obtained as a result of any fraudulent conduct.

Ritz's Brief, p. 21 (emphasis added). This caption is unfathomable, given that Husky has never contended that Chrysalis fraudulently obtained any property.

Ritz's error likely derives from his assumption that in order to make the debt to Husky nondischargeable, Ritz's fraud could only have occurred at the inception of the commercial debt from Chrysalis to Husky. This is incorrect. See ***McClellan***, 217 F.3d at 895. The Bankruptcy Code defines "debt" very broadly, as "liability on a claim," 11 U.S.C. § 101(12), and "claim" very broadly, as any "right to payment," whether liquidated or unliquidated, disputed or undisputed, legal or equitable. § 101(5); *see generally* ***Johnson v. Home State Bank***, 501 U.S. 78, 83-84 and n.5 (1991). The debt in the case at bar debt need not, therefore, arise from the commercial transaction between Husky and Chrysalis. As in McClellan, the original debt is not the debt at issue here. *Id.* As the ***McClellan*** court wrote:

> **The debt at issue here is the debt that the sister incurred to McClellan by committing a fraud against him. Because it was an actual fraud, the debt that it gave rise to is not dischargeable.**

* * *

Supreme Court, U.S.
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No. 15-145

IN THE

Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC.

Petitioner,

v.

DANIEL LEE RITZ, JR.,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

BRIEF FOR PETITIONER

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QUESTION PRESENTED

Whether the "actual fraud" bar to discharge under § 523(a)(2)(A) of the Bankruptcy Code applies only when the debtor has made a false representation, or whether the bar also applies when the debtor has deliberately obtained money through a fraudulent-transfer scheme that was actually intended to cheat a creditor.

LIST OF PARTIES

The parties in the court below were Husky International Electronics, Inc., and Daniel Lee Ritz, Jr.

RULE 29.6 DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, Petitioner Husky International Electronics, Inc., discloses that it is a privately held corporation that has no parent corporation and no publicly traded stock, and no publicly held company owns more than 10% of its stock.

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OPINIONS BELOW

The opinion of the Fifth Circuit (Pet. App. 1a) is reported at 787 F.3d 312. The opinion of the district court (Pet. App. 21a) is reported at 513 B.R. 510. The opinion of the bankruptcy court (Pet. App. 78a) is reported at 459 B.R. 623.

JURISDICTION

The Fifth Circuit entered judgment on May 22, 2015. JA35. Petitioner filed a petition for writ of certiorari on July 30, 2015, which this Court granted on November 6, 2015. 136 S. Ct. 445. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 523 of the Bankruptcy Code, 11 U.S.C. § 523, provides:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> ...
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;
>
> ....

STATEMENT OF THE CASE

Petitioner Husky International Electronics, Inc. ("Husky") sold and delivered electronic device components to Chrysalis Manufacturing Corporation

("Chrysalis"). Chrysalis never fully paid Husky. It could not. One of its owners, Respondent Daniel Lee Ritz, Jr. ("Ritz"), bankrupted Chrysalis, draining it of its assets and funneling them to other companies he controlled. These transfers allowed Ritz to benefit from Chrysalis's assets while shielding them from Chrysalis's creditors. Husky sued Ritz, arguing that he was personally liable for Chrysalis's debt to Husky because he used Chrysalis to perpetrate fraud for his own benefit. Ritz then filed for bankruptcy, and Husky initiated this adversary proceeding to bar discharge of Ritz's personal debt to Husky.

The Bankruptcy Code does not reward Ritz's fraudulent scheme. To the contrary, Congress specifically amended § 523(a)(2)(A) to prevent discharge of debts stemming from "actual fraud." That term has long been understood to include a transferee's receipt of property in a transaction that he knows is intended to defraud creditors. The Fifth Circuit nevertheless held that § 523(a)(2)(A) allows Ritz to erase the debt resulting from his deliberate fraud—for the sole reason that his fraud did not include a misrepresentation to Husky.

A. The Bankruptcy Code Bars Discharge Of Debts For Money Obtained By Actual Fraud

The Bankruptcy Code embodies the "basic policy" of "affording relief only to an 'honest but unfortunate debtor.'" *Cohen v. de la Cruz*, 523 U.S. 213, 217 (1998) (quoting *Grogan v. Garner*, 498 U.S. 279, 287 (1991)); *see Brown v. Felsen*, 442 U.S. 127, 128 (1979). To that end, although the Bankruptcy Code generally gives debtors a fresh start, it also bars discharge of

debts for various kinds of crimes, civil torts, and other wrongdoing. *See, e.g.*, 11 U.S.C. § 523(a)(2)(A) (fraud and misrepresentation); *id.* § 523(a)(4) (embezzlement and larceny); *id.* § 523(a)(9) (driving under the influence); *id.* § 523(a)(19) (violations of securities laws).

Section 523(a)(2)(A) specifically reflects Congress's judgment that "the interest in protecting victims of fraud" outweighs "the interest in giving perpetrators of fraud a fresh start." *Grogan*, 498 U.S. at 287; *see Cohen*, 523 U.S. at 221. It excepts from discharge "any debt ... for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by ... false pretenses, a false representation, or actual fraud." 11 U.S.C. § 523(a)(2)(A); *see also* 11 U.S.C. §§ 727(b), 1328(a)(2) (making the discharge exceptions of § 523(a)(2)(A) applicable to individual bankruptcies under Chapters 7 and 13). Congress added the particular phrase "*actual fraud*" to § 523(a)(2)(A) in 1978, when it enacted the current Bankruptcy Code. Pub. L. No. 95-598, § 523(a)(2)(A), 92 Stat. 2549, 2590 (1978) (emphasis added).[1] That amendment accomplished two important objectives.

First, it restored the Code to align with earlier bankruptcy laws that had barred the discharge of debts arising from all intentionally fraudulent conduct. Before the 1978 amendment, § 523(a)(2)(A) barred discharge of "liabilities for obtaining money or

---

[1] Section 523(a)(2) replaced § 17(a)(2) of the then-existing Bankruptcy Act, 11 U.S.C. § 35(a)(2) (1976). *See* H.R. Rep. No. 95-595, at 364 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6320.

property by *false pretenses* or *false representations*." 11 U.S.C. § 35(a)(2) (1976) (emphasis added). But—unlike even earlier Bankruptcy Acts—it did not bar discharge of *other* types of fraud.[2]

For example, the Bankruptcy Act of 1867 expansively barred discharge of debts "created by the fraud ... of the bankrupt." Bankruptcy Act of 1867, ch. 176, § 33, 14 Stat. 517, 533. Congress amended this provision in 1898 to specify that the discharge bar applies to "debts ... [that] are judgments in actions for frauds, or obtaining property by false pretenses or false representations." Bankruptcy Act of 1898, ch. 541, § 17(a)(2), 30 Stat. 544, 550.

When Congress amended this provision again in 1903, it removed the discharge bar for "frauds," leaving only "false pretenses or false representations." *See* Ch. 487 § 17(a)(2), 32 Stat. 797, 798 (1903). It did so despite concerns from some members that the Bankruptcy Act should continue to prevent the discharge of debts for the "many *other* frauds ... besides false pretenses and false representations." 36 Cong. Rec. H1376 (statement of

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[2] The iteration of the Code in effect before the 1978 amendment to § 523(a)(2)(A) included a separate bar for discharge of debts that "were created by [a debtor's] fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity." 11 U.S.C. § 35(a)(4); *see also* Bankruptcy Act of 1898, ch. 541, § 17(a)(2), 30 Stat. 544, 550-51 (same). This discharge bar, which the 1978 amendments retained, *see* Pub L. No. 95-598, § 532(a)(4), 92 Stat. at 2591, applied only to fraud committed in a fiduciary capacity and thus did not capture frauds committed by non-fiduciaries. *See Crawford v. Burke*, 195 U.S. 176, 190 (1904).

Rep. Mann) (daily ed. Jan. 28, 1903) (emphasis added).

Congress closed this gap in 1978, amending § 523(a)(2)(A) so that "'actual fraud' is added as a grounds for exception from discharge." S. Rep. No. 95-989, at 78 (1978); H.R. Rep. No. 95-595 at 364. Because § 523(a)(2)(A)'s predecessor had already barred debts arising from "false pretenses" and "false representations," Congress's addition of "actual fraud" covered the "many other frauds" that previously had fallen outside the provision's scope.

Second, Congress's 1978 amendment "codif[ied]" the understanding of actual fraud articulated in *Neal v. Clark*, 95 U.S. 704 (1887). 124 Cong. Rec. H32399 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards); 124 Cong. Rec. S33998 (daily ed. Oct. 5, 1978) (statement of Sen. DeConcini). Interpreting an earlier version of the Bankruptcy Code's fraud discharge bar, *Neal* explained that "*actual* fraud" means *intentional* fraud—that is, fraud in which an individual intends "himself to commit a fraud" or "to aid [someone else] in committing one." 95 U.S. at 707 (emphasis added). It further made clear that actual fraud specifically includes a transferee's participation in what he knows to be an intentional fraudulent conveyance. *See id.* Congress incorporated that understanding of actual fraud in § 523(a)(2)(A).

B. Ritz Orchestrates A Scheme To Defraud Husky

Respondent Daniel Lee Ritz, Jr., was at all relevant times in financial control and the partial owner of Chrysalis Manufacturing Corporation. Under Ritz's control, between 2003 and 2007,

Chrysalis purchased electronic components from Petitioner Husky International Electronics, Inc. Husky delivered the components, but Chrysalis never fully paid for them, leaving a total unpaid debt of $163,999.38. Pet. App. 2a.

While this debt was outstanding, Ritz fraudulently transferred over a million dollars from Chrysalis to at least seven other entities that he owned and controlled. *See* Pet. App. 2a. Chrysalis was insolvent during this time, was not paying its debts as they became due, and did not receive reasonably equivalent value in exchange for the transfers. Pet. App. 3a.

As Ritz himself admitted, such transfers personally benefitted him. *See* JA53-55. Before the transfers, Chrysalis held $163,999.38 that it owed to Husky. After Ritz drained Chrysalis of its assets, his other companies held an extra $163,999.38—and they did so free of any obligations to Husky. Ritz personally benefitted from these transactions because he owned and controlled the newly enriched businesses to which he diverted assets from Chrysalis.

C. After Husky Sues Ritz To Hold Him Personally Liable For His Fraud, Ritz Files for Bankruptcy And Attempts To Discharge His Debt To Husky

In May 2009, Husky sued Ritz in federal district court to hold him personally liable under Texas law for Chrysalis's debt to Husky of $163,999.38. Pet. App. 3a. Seven months later, and before Husky's case against Ritz in federal district court could be decided, Ritz filed a voluntary petition for bankruptcy under Chapter 7. Pet. App. 3a.

In March 2010, Husky initiated an adversary proceeding in the bankruptcy court, arguing that Ritz's debt to Husky was nondischargeable under the actual fraud bar of 11 U.S.C. § 523(a)(2)(A). *First*, Husky argued that the transfers from Chrysalis to Ritz's other companies, made "with actual intent to hinder, delay, or defraud [Chrysalis's] creditor[s]," were fraudulent under the Texas Uniform Fraudulent Transfer Act. Tex. Bus. & Com. Code § 24.005(a). *Second*, because Ritz caused Chrysalis "to be used" to "perpetrate" this "actual fraud" for his own "direct personal benefit" (as owner of the companies that received assets from Chrysalis), he was *personally* liable to Husky for the fraud under Texas's veil-piercing statute. Tex. Bus. Orgs. Code § 21.223(b); *see Tryco Enters., Inc. v. Robinson*, 390 S.W.3d 497, 509-11 (Tex. App. 2012) (piercing the veil under § 21.223(b) and holding owners personally liable for a fraudulent transfer of one company's assets to another company that they owned); *In re Morrison*, 361 B.R. 107, 120 (Bankr. W.D. Tex. 2007) (piercing the veil and imposing personal liability where "majority stockholder and President" of company used company to perpetrate a fraud and resulting "benefit to [the company] was a personal benefit to [him]"). *Third*, and as pertinent here, Ritz's "debt" to Husky—for "money" or "property" that Ritz "obtained by ... actual fraud," i.e., through his fraudulent-transfer scheme—is nondischargeable under 11 U.S.C. § 523(a)(2)(A).[3]

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[3] Husky also argued that Ritz's debt was nondischargeable under 11 U.S.C. § 523(a)(4), which applies to debts for fraud in a fiduciary capacity, and 11 U.S.C. § 523(a)(6), which applies to

D. The Lower Courts Find Ritz's Debt Dischargeable For The Sole Reason That His Fraud Against Husky Did Not Involve A Misrepresentation

1. The bankruptcy court held a four-day bench trial in February 2011. Although it found that Ritz intentionally drained Chrysalis of assets, it held that his debt to Husky was dischargeable because he made no misrepresentation to Husky.

At trial, Ritz testified that he "w[as] responsible for initiating and authorizing most ..., if not all, ... of the transfers of cash from Chrysalis to [his] various entities." JA51-52; *see* JA49 (admitting that Ritz "initiate[d] and authorize[d] many of the transfers" from Chrysalis to other businesses he controlled). He agreed that, "if money got moved, [he] knew about it and probably, in most cases, instructed it." JA47. Indeed, the employee responsible for executing the transfers testified that she "didn't take direction from anybody else to move funds other than Mr. Ritz." JA67. And another witness with access to the

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(continued...)

debts for "willful and malicious injury by the debtor." *See* Pet. App. 79a. The bankruptcy court rejected Husky's reliance on § 523(a)(4), Pet. App. 93a, a ruling that Husky did not appeal, *see* Pet. App. 3a n.2. Furthermore, despite the bankruptcy court's finding that Ritz "was trying to drain" Chrysalis, JA82, and the district court's finding that Ritz used Chrysalis to defraud creditors, Pet. App. 68a-69a, both courts found that Husky failed to meet its burden to show that Ritz intended to willfully and maliciously injure Husky, as required by § 523(a)(6), Pet. App. 77a, 96a-97a. The Fifth Circuit affirmed. Pet. App. 18a.

"financial records" of Ritz's companies testified that there was no doubt "in [his] mind" that Ritz "was running the show financially speaking." JA71.

Ritz further agreed that such transfers from Chrysalis to his other companies benefited him personally. JA53-55. And although he characterized the "hundreds" of payments among his companies as "loans," Ritz admitted that "there were no repayment terms," and that "none" of the so-called loans were "documented with any notes or anything else." JA42; JA55. One of his employees further confirmed that "there were no loan documents," and the payments were not "official loans." JA67.

The bankruptcy court concluded that Ritz was "not a credible witness." Pet. App. 83a. It highlighted his "blatantly contradictory" and "evasive[]" testimony, which was at times "disingenuous, if not downright misleading"; it also noted his "selective" inability to remember certain information when questioned under oath on the witness stand. Pet. App. 83a-85a; *see* Pet. App. 98a ("the Debtor is not an upstanding businessman who can be trusted"); JA82 ("I don't believe Mr. Ritz. I found him to be a witness with virtually no credibility.").

Ritz himself recognized that much of his testimony represented "dramatic changes" to earlier statements he made under oath and during discovery. JA47 ("Q: [Y]ou have come to court and you have made dramatic changes in the sworn testimony you gave, isn't that true, sir? A: I think there are some changes, yes sir."); *see also*, *e.g.*, JA41; JA51. For example, although he testified at his March 2008 deposition that the loans were "documented in the

form of a note or loan agreement," he admitted at trial that there were no such records. JA42-44. And while Ritz testified at trial that he "initiate[d] and authorize[d] many of the transfers" from Chrysalis, he stated in his interrogatory responses that he "did not initiate or authorize any of th[e] transfers." JA49-50. Ritz never corrected or updated his prior statements; rather, he claimed at trial that he "ha[d] a much more full understanding of the facts now than [he] did then." JA45-47. Not surprisingly, other witnesses testified that they had a "[p]oor" "opinion of Mr. Ritz's character for truthfulness." JA68; *see* JA73 ("Q: You don't have a very high opinion of Mr. Ritz today, do you? A: Well no, I do not."); JA77-78 (witness was "disappointed" by Ritz's interrogatory responses because he "did not believe them to be truthful").

In August 2011, the bankruptcy court made findings of fact and conclusions of law. Pet. App. 78a. The court found that Ritz intentionally "drained substantial funds out of Chrysalis's operating account and funneled these funds to other entities [he] controlled." Pet. App. 98a. As the bankruptcy court put it, "I think [Ritz] drained Chrysalis of a lot of money.... I think he was *trying* to drain that company." JA82 (emphasis added). The court further found that the transfers "orchestrat[ed]" by Ritz were not made for reasonably equivalent value, and that Husky suffered damages in the full amount of $163,999.38. Pet. App. 82a.

Nevertheless, the bankruptcy court held as a matter of law that Ritz's conduct did not constitute "actual fraud" under § 523(a)(2)(A) for the sole reason that he did not make any "false representation" to

Husky in the course of his fraudulent-transfer scheme. Pet. App. 92a.[4] The bankruptcy court encouraged Husky to appeal its decision, emphasizing that "what Mr. Ritz did should not be allowed." JA84. The court further stated, "I don't think I've ever said this on the record, but I'm going to say it now. I hope you do appeal me. I hope an Appellate Court tells me I'm wrong, because I don't believe Mr. Ritz. I think he was trying to drain that company." JA82.

2. Husky appealed to the district court. That court held that Ritz was personally liable to Husky under Texas law. It first explained that Texas law imposes personal liability on a shareholder who uses a corporation to perpetrate an "actual fraud" for his personal benefit. Pet. App. 69a-70a (citing Tex. Bus. Orgs. Code § 21.223). Contrary to the bankruptcy court's ruling, the district court held that actual fraud under Texas law does "*not* require a misrepresentation." Pet. App. 69a (emphasis added). Rather, actual fraud includes a transfer made "with actual intent to hinder, delay, or defraud creditors." Pet. App. 71a-72a (quoting Tex. Bus. Orgs. Code § 24.005(a)(1)). The court accordingly held that Ritz was personally liable to Husky under Texas law "[b]ecause ... Ritz caused Chrysalis to be used for the purpose of perpetrating and did perpetrate an actual fraud on its creditors primarily for Ritz's direct personal benefit, i.e., he drained Chrysalis of funds

[4] For the same reason, the bankruptcy court held that Ritz had not committed "actual fraud" under Texas law and therefore was not personally liable to Husky. Pet. App. 92a; *see* Tex. Bus. Orgs. Code § 21.223(b).

and fraudulently transferred those funds to other entities under his control and/or ownership." Pet. App. 68a-69a.

The district court nevertheless held that, as a matter of federal law, Ritz's debt to Husky was dischargeable in bankruptcy. Despite acknowledging that "actual fraud" under Texas law does not require a misrepresentation, the district court determined that § 523(a)(2)(A)'s use of the same phrase *does* require a misrepresentation. Pet. App. 72a. The dispositive legal issue, according to the district court, was that Husky failed to allege a misrepresentation by Ritz, and therefore his conduct could not constitute "actual fraud" within the meaning of § 523(a)(2)(A). Pet. App. 73a-74a.

3. The Fifth Circuit affirmed, holding that a false representation by the debtor "is a necessary prerequisite for a showing of 'actual fraud' under Section 523(a)(2)(A)." Pet. App. 17a. In light of that conclusion, and because "the parties agree[d]" that Ritz's fraudulent-transfer scheme did not involve a misrepresentation, the court held that § 523(a)(2)(A) did not bar the discharge of Ritz's debt to Husky. Pet. App. 17a. The court did not reach Ritz's arguments that he was not personally liable to Husky under Texas law, Pet. App. 6a, that "the debt at issue was not 'obtained by fraud,'" and that "Ritz did not make the transfers with the intent to deceive Husky," Pet. App. 7a n.4.

The Fifth Circuit acknowledged the Seventh Circuit's contrary interpretation of § 523(a)(2)(A) in *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000). Pet. App. 7a. *McClellan* held that "actual fraud"

under § 523(a)(2)(A) "is not limited to misrepresentations and misleading omissions," but also includes deliberate fraudulent-transfer schemes. 217 F.3d at 893. *McClellan* explained that "fraud" itself "includes all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated," and "*actual* fraud" means that the fraud was intentional. *Id.* (internal quotation marks omitted; emphasis added). "[B]y distinguishing between 'a false representation' and 'actual fraud,'" the court further explained, § 523(a)(2)(A) "makes clear" that "actual fraud" "is not limited to misrepresentations and misleading omissions" and includes transfers "intended ... to hinder ... creditors." *Id.* at 893-94. The First Circuit later followed *McClellan* in *In re Lawson*, holding that "the 'actual fraud' exception to discharge under § 523(a)(2)(A) includes knowing receipt of a fraudulent conveyance" designed to hinder, delay, or defraud creditors. 791 F.3d 214, 225 (1st Cir. 2015).

Parting ways with *McClellan*, the Fifth Circuit based its narrow understanding of actual fraud on this Court's decision in *Field v. Mans*, 516 U.S. 59 (1995). *Field* addressed "the level of reliance that § 523(a)(2)(A) requires a creditor to demonstrate" in order to bar discharge where the debtor has allegedly committed fraud by misrepresentation. *Id.* at 63. The Fifth Circuit recognized that *Field* did not "directly address[] the issue" of whether actual fraud requires a misrepresentation—indeed, the *Field* Court had no reason to consider other possible forms of fraud because "the facts underlying *Field* involved a misrepresentation." Pet. App. 10a-11a. But the Fifth Circuit nevertheless stated that "[the] opinion

in *Field* appeared to assume that a false representation is necessary to establish 'actual fraud.'" Pet. App. 10a (citing *Field*, 516 U.S. at 68, 79).

The Fifth Circuit further noted that "another provision of the Bankruptcy Code, Section 727(a)(2), excepts from discharge certain fraudulent transfers," and it surmised (without elaboration) that other provisions of the Bankruptcy Code "may be rendered redundant" by *McClellan*'s understanding of actual fraud. Pet. App. 16a (citing 11 U.S.C. §§ 727(a)(2), 523(a)(4), 523(a)(6)). Finally, the Fifth Circuit observed that, "to the extent Section 523(a)(2)(A) is ambiguous, 'exceptions to discharge should be construed in favor of debtors in accordance with the principle that provisions dealing with this subject are remedial in nature and are designed to give a fresh start to debtors unhampered by pre-existing financial burdens.'" Pet. App. 16a (quoting *Fezler v. Davis*, 194 F.3d 570, 573 (5th Cir. 1999)).

SUMMARY OF ARGUMENT

In 1978, Congress added "actual fraud" to § 523(a)(2)(A). Before the amendment, § 523(a)(2)(A) already barred the discharge of debts arising from all manner of intentional misrepresentations ("false pretenses" and "false representations"). Congress did not add "actual fraud" to § 523(a)(2)(A) merely to repeat its preexisting scope. Rather, Congress's amendment must have substantive meaning. That meaning—drawn from hundreds of years of common-law cases and from this Court's case law, which Congress codified—is that actual fraud refers to any intentional fraud, and includes a transferee's

participation in a transfer scheme that he knows is intended to defraud creditors. Actual fraud does not categorically require a misrepresentation, and this Court should reverse the Fifth Circuit's contrary conclusion.

I. This Court interprets terms in the Bankruptcy Code in accordance with their common-law meaning. At common law, the term *actual* fraud has long meant *intentional* fraud. As this Court explained in *Neal* (the decision Congress codified when it added "actual fraud" to § 523(a)(2)(A), *see supra* at 5), the difference between actual fraud and constructive fraud hinges on the actor's motives. It has nothing to do with whether the fraud involves a misrepresentation or takes some other form. Indeed, the common law has long recognized many forms of fraud; some involve misrepresentations, and others do not. Thus, *Neal* made clear that receiving a fraudulent transfer, with intent to commit a fraud or to help the transferor in doing so, makes the transferee liable for actual fraud. That is so even though the transferee's fraud involves no misrepresentation whatsoever.

Neal's understanding of actual fraud is consistent with centuries of common-law jurisprudence, including in the specific context of debtor-creditor relations. The common law has always recognized that conveyances that hinder creditors' rights are a form of fraud. When a debtor transfers his property *intending* to defraud creditors, he engages in actual fraud. And because a transferee who receives property through such a conveyance *knowing* of its fraudulent purpose is actively participating in the fraud and aiding its consummation, courts have long

held that he, too, commits actual fraud. Section 523(a)(2)(A) therefore bars the discharge of the transferee's debt arising from his knowing participation in the scheme.

II. The structure, history, and purpose of § 523(a)(2)(A) further confirm that actual fraud does not categorically require a misrepresentation.

Before Congress amended § 523(a)(2)(A) to bar discharge of debts arising from "actual fraud," the provision already applied to debts for money or property obtained by "false pretenses" and "false representations." These two terms had distinct meanings, collectively barring discharge of debts for all criminal ("false pretenses") and civil ("false representations") forms of intentional misrepresentations. In amending the statute, Congress sought to extend the discharge bar to an additional type of wrongdoing. After all, Congress did not amend § 523(a)(2)(A) merely to repeat the range of intentional misrepresentations that the statute already covered. Rather, actual fraud must mean something in addition to an intentional misrepresentation. As the First and Seventh Circuits recognized, the common-law understanding of actual fraud provides that additional meaning: Actual fraud refers to all intentional fraud, including deliberately fraudulent conveyances.

Section 523(a)(2)(A)'s surrounding text also easily encompasses debts for money or property obtained by what the recipient knows to be an intentionally fraudulent transfer. Section 523(a)(2)(A) bars discharge of "any debt ... for money [or] property ... to the extent obtained by ... actual fraud." As this

Court has explained, a "debt" means any enforceable obligation, and the phrase "obtained by" requires that the defendant receive money or property as a result of his fraud. Because a transferee who receives property knowing of the fraudulent nature of the conveyance is himself guilty of actual fraud, he "obtain[s]" "money" or "property" "by ... actual fraud." 11 U.S.C. § 523(a)(2)(A).

This understanding of actual fraud is also consistent with the Bankruptcy Code's policy of affording relief to only the honest but unfortunate debtor. Congress has long sought to prevent the Bankruptcy Code from becoming an engine of fraud and corruption. Indeed, that is the very purpose of § 523(a)(2)(A)'s discharge bar for debts resulting from fraud. In enacting this broad discharge bar and expanding it to include "actual fraud," Congress did not intend to carve out—and thereby encourage—forms of actual fraud that happen not to involve a misrepresentation.

III. The Fifth Circuit nevertheless held that Ritz's claim is dischargeable under § 523(a)(2)(A), solely because it concluded that "actual fraud" categorically requires a misrepresentation. In so holding, the Fifth Circuit misread *Field*, a decision in which this Court never considered (and had no reason to consider) whether misrepresentation is the *only* type of fraud that can give rise to a nondischargeable debt under § 523(a)(2)(A). Moreover, *Field*'s *methodology*—looking to the common-law understanding of actual fraud against which Congress amended the statute in 1978—disproves the Fifth Circuit's holding. The Fifth Circuit also incorrectly surmised, largely without explanation, that Husky's interpretation of

actual fraud would render other provisions of the Bankruptcy Code superfluous. Finally, the Fifth Circuit relied on the Code's "fresh start" policy to support its narrow construction of § 523(a)(2)(A). But Congress has determined that protecting victims of fraud outweighs the interest in giving perpetrators of fraud a fresh start.

ARGUMENT

Section 523(a)(2)(A) bars the discharge of "any debt ... for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by ... false pretenses, a false representation, or actual fraud[.]" The question presented asks what "actual fraud" means: Does it categorically require a misrepresentation, or does it also include an intentional fraudulent transfer?

The common-law meaning of actual fraud, the statutory structure and history of § 523(a)(2)(A), and the policies underlying the Bankruptcy Code all point to the same answer: Actual fraud includes a transferee's participation in a conveyance that he knows is intended to defraud creditors.

I. THE COMMON-LAW MEANING OF ACTUAL FRAUD HAS ALWAYS INCLUDED FRAUDULENT CONVEYANCES INTENDED TO CHEAT CREDITORS

This Court "begin[s] with the language employed by Congress and the assumption that the ordinary meaning of that language accurately expresses the legislative purposes." *Engine Mfrs. Ass'n v. S. Coast Air Quality Mgmt. Dist.*, 541 U.S. 246, 252 (2004) (internal quotation marks omitted). "It is well established that where Congress uses terms that

have accumulated settled meaning under the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms." *Field*, 516 U.S. at 69 (internal quotation marks and citation omitted). And when Congress added "actual fraud" to § 523(a)(2)(A) in 1978, that term had a settled meaning that encompassed a transferee's participation in a deliberate fraudulent-transfer scheme, knowing of its fraudulent purpose.

The common law recognized many forms of fraud, some of which required a misrepresentation and others of which did not. As this Court explained in *Neal*, *actual* fraud means *intentional* fraud. The modifier "actual" refers to the perpetrator's mindset—i.e., intentionally fraudulent conduct, as distinct from fraud implied in law. It is thus "unrelated to whether the intent to defraud was implemented by a misrepresentation or by some other improper means." *McClellan*, 217 F.3d at 894. Indeed, *Neal* applied the term "actual fraud" to conduct that did not involve any misrepresentation at all.

Countless common-law cases, including in the context of debtor-creditor relations, confirm this understanding of actual fraud. The common law has long recognized that conveyances that hinder creditor rights are a form of fraud. When those conveyances are orchestrated with an intent to defraud creditors, courts have always referred to them as a form of actual fraud. And when a defendant receives property in such a scheme, knowing of its fraudulent purposes, he, too, commits actual fraud. Congress incorporated this settled meaning in § 523(a)(2)(A).

A. Actual Fraud Is Any Intentional Fraud

When Congress added "actual fraud" to § 523(a)(2)(A) in 1978, the term was understood to mean any intentionally fraudulent conduct (regardless of whether the particular form of fraud involved a misrepresentation). This Court recognized that meaning more than 100 years ago in *Neal*, and Congress amended § 523(a)(2)(A) with that understanding in mind. *See supra* at 5.

1. In *Neal*, the executor of an estate sold two of the estate's bonds to Neal at a significant discount. *See* 95 U.S. at 704. The sale of these bonds for less than their true worth constituted a *devastavit* on the estate and its beneficiaries, a type of fraudulent conveyance. *See id.* at 706; *see also, e.g.*, *Everingham v. Vanderbilt*, 51 How. Pr. 177, 183 (N.Y. 1876). When the executor was called to account for the distribution of the estate's assets, the court ordered him to provide a new bond to the beneficiaries to make up for the *devastavit* he committed by selling the estate's property to Neal for too low a price. *See Neal*, 95 U.S. at 704-05. He did so, with others as sureties for the new bond. *See id.* The executor subsequently became insolvent, and the sureties on the executor's bond sued Neal. They alleged that Neal was directly liable to the estate's beneficiaries for fraud because he had participated in the *devastavit*. *Id.* at 705. Neal declared bankruptcy and argued that his debt arising from the purchase of the bonds was dischargeable. *Id.* This Court therefore considered whether Neal's debt fell within § 33 of the Bankruptcy Act of 1867, which provided that "no debt created by the fraud ... of the bankrupt ... shall be discharged under this act." *See id.* at 706 (quoting

Bankruptcy Act of 1867, ch. 176, § 33, 15 Stat. at 533).

To answer that question, the Court had to determine whether Neal's participation in the executor's *devastavit* constituted actual fraud, as opposed to merely constructive fraud, because the Court construed the Bankruptcy Act to bar discharge for only actual fraud. *See id.* at 707, 709. This question, the Court explained, hinged on Neal's *motives*. Actual fraud is "positive fraud, or fraud in fact, involving moral turpitude or intentional wrong," *id.* at 709, such that the actor intends either "himself to commit a fraud" or "to aid [someone else] in committing one," *id.* at 707. Constructive fraud, by contrast, is "implied fraud, or fraud in law," *id.* at 709, and thus may exist despite the actor's "good faith" or lack of knowledge, *id.* at 707.

The Court held that Neal's debt was dischargeable because it resulted from constructive fraud. *See id.* at 709. The fraud was merely constructive because Neal "purchased the bonds in good faith," without fraudulent intent, and "having no reason to believe" that the executor who sold him the bonds intended "any wrong to those interested in the estate which he was administering." *Id.* at 707. Conversely, however, had Neal "entertained any purpose himself to commit a fraud, or to aid the executor in committing one," then his purchase of fraudulently transferred property would have made him guilty of "actual fraud." *Id.*

2. *Neal*'s analysis illustrates two important points, which other cases corroborate. *First*, *Neal* confirms that the line between actual and

constructive fraud hinges on the actor's intent. *See id.* at 707, 709. Similarly, in *Coder v. Arts*, this Court considered whether a debtor's conveyance to one of his creditors was void under the Bankruptcy Code. 213 U.S. 223, 231 (1909). The answer depended on whether the conveyance constituted an actual fraud—an inquiry that, the Court explained, "depends upon the motive." *Id.* at 242. Because the grantor "had no intention to hinder, delay, or defraud his creditors," and the recipient acted in good faith, "was ignorant of the insolvency of the grantor, and had no reason to believe that a preference was intended," the Court concluded that there was no actual fraud. *Id.* at 244-45. *See also, e.g.*, *Bullis v. O'Beirne*, 195 U.S. 606, 617, 620-21 (1904) (finding actual fraud based on the actor's intent to deceive); *Ames v. Moir*, 138 U.S. 306, 312 (1891) ("vital inquiry" whether defendant's conduct constituted actual or merely constructive fraud hinged on whether he intended to defraud others).

Second, *Neal* established that whether conduct is actual fraud does not depend on whether the perpetrator made a misrepresentation. After all, Neal did not make any false statements, but his participation in the *devastavit* was a form of fraud. *See* 95 U.S. at 707-08. And Neal *would* have been guilty of *actual* fraud—and his debt for fraud would have been nondischargeable under the early precursor of § 523(a)(2)(A)—if only "he entertained any purpose himself to commit a fraud, or to aid the executor" in the fraudulent transfer. *Id.* at 707.

Indeed, common-law fraud has long "encompass[ed] many different and ever-innovative forms." *Wallace v. Wallace*, 291 S.E.2d 386, 387 (W.

Va. 1982). That is because fraud is a "generic term" that "includes all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated." *McClellan*, 217 F.3d at 893; *see Lawson*, 791 F.3d at 219, 225 (same); *see also, e.g.*, *Chien v. Chen*, 759 S.W.2d 484, 494-95 (Tex. App. 1988) ("At common law, the word 'fraud' refers to an act, omission, or concealment in breach of a legal duty, trust, or confidence justly imposed, when the breach causes injury to another or the taking of an undue and unconscientious advantage." (emphasis deleted)); *Arizona v. Scofield*, 438 P.2d 776, 781 (Ariz. Ct. App. 1968) ("Fraud is a generic term which embraces all the multifarious means which human ingenuity can devise and are resorted to by one individual to get an advantage over another." (internal quotation marks omitted)); *Seeberg v. Norville*, 85 So. 505, 507 (Ala. 1920) ("[F]raud consists in acts, or omissions to act, which involve a breach of legal duty, trust, or confidence, which are injurious to the party complaining[.]"); *Smith v. Harrison*, 2 Heisk. 230, 243 (Tenn. 1870) (Fraud "embraces 'all acts, omissions, or concealments which involve a breach of legal and equitable duty, trust or confidence justly reposed, and are injurious to another, or by which an undue and unconscientious advantage is taken of another.'" (quoting 1 Bouv. L.D., 613)).

To be sure, at common law, some forms of fraud, such as the tort of deceit, did require "a misrepresentation of fact, opinion, intention, or law." Restatement (Second) Torts § 525 (1977); *see also, e.g.*, Restatement (Second) Contracts § 164(1) (1981) (contract voidable if "assent is induced by either a fraudulent or a material misrepresentation by the

other party"). But others plainly did not. For example, "[a]ll undue influence is a species of fraud." *Cox v. Hale*, 114 So. 465, 467 (Ala. 1927); *see, e.g.*, *Redford v. Booker*, 185 S.E. 879, 885 (Va. 1936). So, too, are conveyances that defraud another of his property rights, including transfers that diminish an estate, *see Neal*, 95 U.S. at 707; *Everingham*, 51 How. Pr. at 183; transfers intended to defeat a divorcing spouse's property interest, *see, e.g.*, *Wallace*, 291 S.E.2d at 388; and transfers that hindered or delayed creditors, *see Lawson*, 791 F.3d at 219-220 & n.7; *McClellan*, 217 F.3d at 893-94; *infra*, Part I.B. *See also* 37 Am. Jur. 2d Fraud and Deceit § 5 ("[c]ollusion" to "defraud another of his or her rights by the forms of law or to secure an object forbidden by law" is "a species of fraud").

In sum, at common law, actual fraud meant *intentional* fraud, without regard for whether the particular fraudulent conduct involved a misrepresentation.

B. Common-Law Actual Fraud Has Always Included The Knowing Receipt Of A Deliberately Fraudulent Conveyance

As particularly relevant here, it has long been clear that conveyances orchestrated with an *intent* to hinder, delay, or defraud creditors are a type of actual fraud. Indeed, it has been the law for centuries—beginning with the Statute of Elizabeth, which shaped U.S. common law—that both a transferor who initiates such a conveyance and a transferee who receives property through it, knowing of its fraudulent purpose, are liable for actual fraud.

1. Conveyances that are intended to cheat creditors have been a form of actual fraud since at least the sixteenth century. Beginning with the Statute of 13 Elizabeth, the law afforded relief for "'covinous and fraudulent' transfers designed 'to delay, hinder or defraud creditors and others.'" *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 540 (1994) (quoting 13 Eliz., ch. 5 (1571)). Because such transfers were made with "actual fraudulent intent," they were "infected by actual fraud." *Id.* at 535, 540-41 (citing *Twyne's Case*, 3 Coke Rep. 80b, 76 Eng. Rep. 809 (K.B. 1601); O. Bump, Fraudulent Conveyances: A Treatise upon Conveyances Made by Debtors to Defraud Creditors 31-60 (3d ed. 1882)).

Although a *transferor* who conveyed his property intending to cheat creditors was always guilty of actual fraud, the remedy for such transfers turned in part on whether the *recipient* was also culpable. If the recipient was a "bona fide" purchaser who provided "good consideration" and did not have any "notice or knowledge of [the] covin, fraud or collusion" on the part of the transferor, no relief was available to creditors. 13 Eliz., ch. 5[6]. Such good-faith recipients faced no liability for receiving the property because they were not themselves guilty of actual fraud. *See, e.g.*, *Bean v. Smith*, 2 F. Cas. 1143, 1150-53 (C.C.D.R.I. 1821) (discussing cases applying Statute of Elizabeth). But if the recipient knew that the transfer was fraudulent, his purchase "assist[ed] in the consummation of the fraud," making him an equal participant. *Garland v. Rives*, 4 Rand. 282, 304 (Va. 1826) (describing Statute of Elizabeth). Because such a transferee was a party to the actual fraud, he had no rights to the transferred property and the

transfer was void. *See Graham v. Fubber*, 14 C.B. 410, 139 Eng. Rep. 169 (K.B. 1854) (transfer void where defendant knew that it was fraudulent); *Twyne's Case*, 3 Coke Rep. at 83b, 76 Eng. Rep. at 823 (recipient of actually fraudulent transfer convicted of fraud).

For example, in an effort to shield his property from creditors, the debtor in *Twyne's Case* secretly assigned all of it to Twyne, but continued to use the property as his own. 3 Coke Rep. at 80b, 73 Eng. Rep. at 810. When the debtor's creditors attempted to seize the property, Twyne claimed that it belonged to him. *See id.* at 80b, 73 Eng. Rep. at 811 12. The creditors argued that the conveyance to Twyne was fraudulent and therefore void under the Statute of Elizabeth. *See id.* at 80b, 73 Eng. Rep. at 812. Twyne did not dispute that the debtor acted with a fraudulent intent, but he nevertheless claimed that the Statute of Elizabeth's safe harbor preserved the conveyance because he was a bona fide purchaser without knowledge that the transfer was fraudulent. *See id.*; *see also* 13 Eliz., ch. 5[6]. The court disagreed. It held that the safe harbor did not protect Twyne because he was aware of the transfer's fraudulent purpose. *Twyne's Case*, 3 Coke Rep. at 81a-81b, 73 Eng. Rep. at 814. Thus, Twyne himself was guilty of fraud for knowingly participating in a deliberately fraudulent conveyance. *See id.* at 83b, 76 Eng. Rep. at 823.

Graham likewise involved a conveyance that was invalidated under the Statute of Elizabeth because the recipient purchased the property knowing that the transferor intended to hinder creditors. In an effort to "protect his property from the claims of

creditors," a debtor sold all his property to Graham. 14 C.B. at 414, 139 Eng. Rep. at 170. Although Graham himself "did not directly intend to delay or defraud creditors," his *knowledge* that the debtor had that intent was sufficient to render the transaction fraudulent and void under the Statute of Elizabeth. *Id.* at 418, 139 Eng. Rep. at 172; *see id.* at 414, 139 Eng. Rep. at 171.

2. The Statute of Elizabeth, which "was declaratory of the common law," had a significant influence on the development of U.S. law. *Sumner v. Hicks*, 67 U.S. 532, 533-34 (1862); *see, e.g.*, *BFP*, 511 U.S. at 541. Therefore, U.S. courts before 1978 commonly used the term "actual fraud" to refer to fraudulent-transfer schemes that were *actually intended* to hinder or delay creditors, regardless of whether there was any misrepresentation.

In *Coder*, for example, this Court stated:

> What is meant when it is required that [fraudulent] conveyances, in order to be set aside, shall be made with the intent on the bankrupt's part to hinder, delay, or defraud creditors? This form of expression is familiar to the law of fraudulent conveyances, and was used at the common law, and in the statute of Elizabeth, and has always been held to require, in order to invalidate a conveyance, that there shall be *actual fraud*; and it makes no difference that the conveyance was made upon a valuable consideration, if made for the purpose of hindering, delaying, or defrauding creditors. The question of fraud depends upon the motive.

213 U.S. at 242 (emphasis added). The Court concluded that there was no "actual fraud" because the transferor "had no intention to hinder, delay or defraud his creditors," and the recipient acted in "good faith," "was ignorant of the insolvency of the grantor, and had no reason to believe that a preference was intended." *Id.* at 244-45.

While riding Circuit in 1821, Justice Story likewise recognized that conveyances that were deliberately orchestrated to defraud creditors constituted "actual fraud." *Bean*, 2 F. Cas. at 1159. The debtor in *Bean* conveyed everything he owned to his children in order to avoid paying his creditors. *See id.* at 1156-59. Because the transfers were "designe[d] to injure and defeat creditors," Justice Story concluded that they were "infected" with fraud and "utterly void" at common law. *Id.* at 1158-59. Any other result would improperly allow "the [grantor] or his coadjutors in such conduct to reap the fruits of their dishonesty." *Id.* at 1154. Instead, he emphasized, courts must "be rigid in denying" any "indulgence" to those "who are guilty of bad faith" in making or knowingly receiving an actually fraudulent transfer. *Id.* at 1158-59; *see id.* at 1155 ("[A] party enabling another to commit a fraud is made answerable for the consequences[.]").

And in *Lovett v. Faircloth*, the Fifth Circuit explained that "proof of intent to hinder or delay [creditors] is proof of *actual fraud*." 10 F.2d 301, 304 (5th Cir. 1925) (emphasis added). When Faircloth's brother-in-law was on the brink of bankruptcy, Faircloth agreed to loan him money in exchange for a note secured by nearly all of his brother-in-law's property. *Id.* at 302. Creditors subsequently forced the brother-in-law into bankruptcy and argued that

the conveyance to Faircloth was invalid because it "was made with the intent and purpose on the part of the bankrupt to hinder, delay, or defraud creditors," and because "Faircloth was not a purchaser in good faith." *Id.* at 303. The court agreed. In holding that the conveyance was void, it emphasized that Faircloth participated in the transfer "with full knowledge" of his brother-in-law's "intent to hinder and delay creditors." *Id.* at 303-04.

Numerous other cases recognize that "[p]roof of intent to hinder or delay [creditors] is proof of actual fraud." *Hofmann v. La Fontaine*, 16 F. Supp. 748, 752 (D. Wyo. 1936); *see, e.g.*, *Wehrman v. Conklin*, 155 U.S. 314, 328 (1894) (reaffirming longstanding principle that courts must "set aside" any "conveyance [that] is attended with actual fraud"); *Smith v. Wilder*, 120 So. 2d 871, 882 (Ala. 1960) ("An existing creditor seeking to set aside a conveyance may do so ... because of actual fraud," which "denotes the actual mental operation of intending to defeat or delay the rights of the creditor."); *Sands v. Codwise*, 4 Johns. 536, 596-99 (N.Y. Ct. Corr. Err. 1808) (finding that the transfer of a property deed was "fraudulent in fact" and "an act founded in actual fraud," because the transferor intended to transfer the property out of the reach of his creditors for an inadequate price); *see also BFP*, 511 U.S. at 535 (describing transfers made with actual fraudulent intent as "infected by actual fraud").

3. Of particular significance here, and consistent with its historical roots in the Statute of Elizabeth, the common law recognized that a transferee who receives property through what he knows to be a

deliberately fraudulent transfer commits actual fraud himself.

In *Daisy Roller Mills v. Ward*, for example, the defendant received two pieces of property through transfers that he knew were "inten[ded] to hinder, delay, and defraud" creditors. 70 N.W. 271, 272-73 (N.D. 1897). The court held that the defendant's acceptance of such fraudulent transfers "actively and purposely aid[ed] in [their] consummation" and made him a culpable participant in the "actual fraud." *Id.* Because the defendant's fraud was "actual" rather than "constructive," he did not "come[] into court ... with clean hands," and the conveyance was therefore void. *Id.* at 273, 275.

Garland likewise recognized the "importan[ce]" of notice to a purchaser that a conveyance was "inten[ded] to defraud creditors." 4 Rand. at 304 (emphasis deleted). "Such a purchase, with notice of the fraudulent intent," would "assist the consummation of the fraud" and would itself constitute "actual fraud." *Id.* at 304, 307-08. Accordingly, when Garland obtained property through a transaction that he knew was intended to defraud creditors, he was a participant in the actual fraud. *See id.* at 305, 308. He therefore could not seek protection as a bona fide purchaser, and the conveyance was void. *See id.* at 307 ("a party to the *covin* and collusion ... could not be held to be a bona fide purchaser under the *proviso* of the Statute [of Elizabeth]").

It was thus "settled law that, where a grantor and grantee conspire to commit a fraud upon the grantor's creditors," the grantee "partakes of the

fraud with the grantor" and is "a party to a positive fraud." *Stephon v. Topic*, 180 N.W. 221, 223 (Minn. 1920); *see also, e.g.*, *Randolph v. Scruggs*, 190 U.S. 533, 538 (1903) (Holmes, J.) (allegation of "constructive fraud" on part of good-faith assignee would not invalidate the promised transfer, but "[t]he case would be different if the assignee were party to an actual fraud"); *Mackel v. Rochester*, 135 F. 904, 908 (D. Mont. 1905) (defendant committed "actual fraud" when he purchased property in a transaction he knew was intended "to hinder, delay, and defraud" creditors); *Leinbach v. Dyatt*, 230 P. 1074, 1080 (Kan. 1924) (where recipient participates in actually fraudulent scheme, knowing that it is for the purpose of defrauding others, his "own fraudulent conduct" is actual fraud); *Hofmann*, 16 F. Supp. at 749 (finding "actual fraud" on the part of the recipient of a deliberately fraudulent transfer who "intentionally accepted the transfer of funds without consideration" and to "benefit ... herself," knowing that the transfer would "hinder or delay creditors"); *Thompson v. Bickford*, 19 Gil. 1, 4 (Minn. 1872) (recipient's collusion in deliberately fraudulent transfer "present[s] a case of *actual* fraud on the part of [the recipient], as well as [the transferor]"); *Sands*, 4 Johns. at 596-98 (grantee who colluded with transferor to receive deed with intent "to cheat creditors" committed "actual fraud"). And the Bankruptcy Act of 1898 went so far as to impose criminal penalties on any person who "knowingly and fraudulently ... received" property from a bankrupt "with the intent to defeat [the] Act." Bankruptcy Act of 1898, ch. 541, § 29(b), 30 Stat. at 554.

Indeed, *Neal* reaffirms this basis for imposing actual-fraud liability on a transferee. As discussed above, *Neal* involved the sale of estate assets for inadequate consideration. *See* 95 U.S. at 707. There was no question that the executor committed a *devastavit*; nor did this Court question whether Neal's participation in that conduct amounted to a fraud on the estate. *See id.* Although the Court held that Neal was not liable for "actual fraud" because he was an innocent transferee, it made clear that he *would* have committed "actual fraud" if he had known about or been complicit in the trustee's wrongdoing. *See id.* Thus, *Neal* confirms that a party who participates in what he knows to be a fraudulent conveyance is himself guilty of "actual fraud." *See id.*

* * *

When Congress added the words "actual fraud" to § 523(a)(2)(A)'s discharge bar, the term had a settled meaning based on centuries of common-law jurisprudence. Actual fraud has never required a misrepresentation; rather, the term actual fraud has always meant any intentional fraud. Indeed, the common law has long used the term—in the specific context of debtor-creditor relations—to include deliberately fraudulent conveyances. In light of this extensive common-law history, it is clear that § 523(a)(2)(A) includes debts arising from a debtor's receipt of property through what he knows to be an intentionally fraudulent conveyance.

II. THE STRUCTURE, HISTORY, AND PURPOSE OF § 523(a)(2)(A) CONFIRM THAT ACTUAL FRAUD DOES NOT REQUIRE A MISREPRESENTATION

The structure, history, and purpose of § 523(a)(2)(A) further establish that actual fraud includes intentionally fraudulent conveyances, regardless of whether the fraudulent conduct involves a misrepresentation. Before Congress added the words "actual fraud" to § 523(a)(2)(A)'s discharge bar, the provision already barred discharge of debts for money obtained by all forms of intentional misrepresentations. Congress added "actual fraud" to extend the discharge bar to additional forms of fraudulent conduct, not merely to restate the previous scope of § 523(a)(2)(A).

Moreover, the surrounding text of § 523(a)(2)(A) comfortably encompasses debts for money or property that the debtor obtains through conveyances that he knows to be fraudulent. This understanding of § 523(a)(2)(A) is also consistent with the purposes of the Bankruptcy Code, which affords relief only to the honest but unfortunate debtor.

A. Interpreting Actual Fraud To Require A Misrepresentation Would Render Congress's 1978 Amendment Superfluous

Before Congress added "actual fraud" to § 523(a)(2)(A) in 1978, its predecessor provision already barred discharge of debts for property and money obtained by "false pretenses or false representations"—i.e., two different forms of fraudulent conduct that, together, capture all

actionable intentional misrepresentations. Congress's addition of a third category of nondischargeable debts "must have meaning," and, as the First and Seventh Circuits recognized, "the most obvious meaning is the one that comports with common law understanding": Actual fraud means all intentional fraud, including receiving property through a conveyance that the transferee knows is intentionally fraudulent. *Lawson*, 791 F.3d at 220; *see McClellan*, 217 F.3d at 893.

1. "It is ... a cardinal principle of statutory construction that [courts] must give effect, if possible, to every clause and word of a statute." *Williams v. Taylor*, 529 U.S. 362, 404 (2000) (internal quotation marks omitted). Accordingly, this Court has repeatedly recognized the importance of construing a statute so that "'no clause, sentence, or word shall be superfluous, void, or insignificant.'" *Washington Market Co. v. Hoffman*, 101 U.S. 112, 115-16 (1879) (quoting Bacon's Abridgment, sect. 2); *see Duncan v. Walker*, 533 U.S. 167, 174 (2001) (collecting cases).

This interpretive canon is particularly powerful when Congress has amended a statute to add the language at issue. Because Congress is unlikely to enact an amendment "just to state an already existing rule," courts "presume [Congress] intends its amendment to have real and substantial effect." *Stone v. I.N.S.*, 514 U.S. 386, 397 (1995). An interpretation that renders an amendment "superfluous" and "deprives [it] of any effect," *Milner v. Dep't of Navy*, 562 U.S. 562, 575 (2011), "cannot be the proper understanding of the statute," *Pierce Cmty. v. Guillen*, 537 U.S. 129, 145 (2003).

For example, *Louisville & Nashville Railroad Company v. Mottley* involved a statute prohibiting common carriers from demanding or collecting compensation "greater or less or different" than the rates specified in the published tariff. 219 U.S. 467, 473 (1911) (internal quotation marks omitted). In 1906, Congress amended the statute to add the word "different" to the statute's preexisting prohibition on charging rates "greater or less" than the published tariffs. *See id.* at 475. Before the amendment, the terms "greater" and "less," with their distinct meanings, together prohibited carriers from charging either more or less money than the tariff amounts. Congress's addition of the word "different" was not merely a synonym for "greater or less." Rather, this Court read it to proscribe an additional form of deviation from published tariffs, i.e., "the acceptance of property of various kinds ... in place of money for services performed by the carrier." *Id.* at 476. Emphasizing the need to avoid a construction that would render this "material addition" "superfluous or meaningless," this Court therefore held that "different" meant different *in kind* rather than merely different in *amount*. *See id.* at 475-76.

Guillen likewise rejected a statutory interpretation that would render Congress's addition of a single term "an exercise in futility." 537 U.S. at 145. The statute at issue protected from discovery certain data "compiled for the purpose of identifying, evaluating, or planning the safety enhancement" of hazardous roadways. *Id.* at 135 (internal quotation marks omitted). Congress later expanded the evidentiary privilege by "changing the language from 'compiled' to 'compiled *or collected*.'" *Id.* at 145; *see id.* at 135.

Guillen rejected an interpretation of this language that would "protect from disclosure only information that was already protected before the amendment." *Id.* at 145. Such an interpretation, the Court explained, would give Congress's amendment "no 'real and substantial effect' and, accordingly cannot be the proper understanding of the statute." *Id.* *See also, e.g.*, *Milner*, 562 U.S. at 575 (rejecting interpretation of FOIA exemption that would render congressional amendment "superfluous" and "deprive[]" it "of any effect"); *Nat'l R.R. Passenger Corp. v. Boston & Maine Corp.*, 503 U.S. 407, 419 (1992) (rejecting interpretation of statute that would make amendment "superfluous"); *Intercounty Constr. Corp. v. Walter*, 422 U.S. 1, 11 (1975) (same).

2. Congress amended § 523(a)(2)(A) to add "actual fraud" as a third category of wrongdoing for which debts are nondischargeable. That amendment must "have real and substantial effect." *Stone*, 514 U.S. at 397. Because the pre-amendment discharge bar *already* applied to debts arising from false pretenses and false representations—collectively, the full range of unlawful intentional misrepresentations—Congress's addition of "actual fraud" must cover something that the discharge bar did not cover before. *See Guillen*, 537 U.S. at 145; *Louisville*, 219 U.S. at 475-76.

At common law, false pretenses and false representation referred to different kinds of intentional misrepresentations—namely, criminal and tortious assertions or omissions. False pretenses was a crime that Parliament created in 1757 to fill a loophole left by larceny and not filled by any other criminal prohibition. *See* LaFave, SUBSTANTIVE

CRIMINAL LAW § 19.7(a) (citing 30 Geo. II, c. 24 (1757)). Most U.S. states enacted similar statutes, criminally punishing a materially false assertion or omission that "causes the victim ... to pass title to ... his property to the wrongdoer." *Id.* § 19.7; *see also* 35 C.J.S. False Pretenses § 1; 32 Am. Jur. 2d False Pretenses § 1. Moreover, the wrongdoer must *know* "his representation to be false and ... *intend*[] thereby to defraud the victim." LaFave, *supra*, § 19.7 (emphasis added); *see id.* § 19.7(f); *see also* 35 C.J.S. False Pretenses § 1 (false pretense "is calculated and intended to deceive"); 32 Am. Jur. 2d False Pretenses § 28 ("To sustain a charge of obtaining property or money by false pretenses, it is essential to show a fraudulent intent.").

Through the term "false representations," Congress ensured that the discharge bar also applied to debtors who committed tortious misrepresentations, not just those convicted of criminal false pretenses. A "false representation" is "[a] representation which is untrue, willfully made to deceive another to his injury." BLACK'S LAW DICTIONARY 724 (4th ed. St. Paul 1968). Thus, the term is a synonym for fraudulent misrepresentation (also known as "deceit"). *See* Restatement (Second) Torts ch. 22, topic 1 ("Fraudulent Misrepresentation (Deceit)"). Fraudulent misrepresentation was a common-law tort that required a *knowingly* false representation *intended* to induce the victim to act or refrain from acting. *See* Prosser, TORTS § 105 at 685-86 (4th ed. 1971); Restatement (Second) Torts §§ 525, 526, 531, 537, 546.

"False pretenses" and "false representations" therefore have distinct meanings. Collectively, they

cover all forms of intentional *criminal* and *tortious* misrepresentation.[5] Of central importance here, their combined presence in § 523(a)(2)(A)'s predecessor meant that, before Congress amended the Code in 1978, debtors could not obtain a discharge of any debt resulting from any *intentional misrepresentation.*

By adding a third category to § 523(a)(2)(A) ("actual fraud"), Congress did not merely add a term that overlapped completely with the scope of the two other preexisting categories of nondischargeable debts. After all, Congress does not amend statutes "just to state an already existing rule." *Stone*, 514 U.S. at 397. Congress's addition of "actual fraud" must cover something in addition to intentional misrepresentations. *See Guillen*, 537 U.S. at 145; *Louisville*, 219 U.S. at 475-76. And indeed, the settled understanding of actual fraud—set forth in the common law and in *Neal*, which Congress codified in § 523(a)(2)(A)—explains the meaning of Congress's amendment. *See supra*, Part I.

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[5] Some courts have further distinguished between false pretenses and false representations on the grounds that the former may be implied from conduct, while the latter requires an express statement. *See, e.g.*, *In re Appling*, 527 B.R. 545, 549-50 (Bankr. M.D. Ga. 2015); *In re Hartley*, 479 B.R. 635, 642 (S.D.N.Y. 2012); *In re Blackburn*, 68 B.R. 870, 877 n.2 (Bankr. N.D. Ind. 1987).

B. The Surrounding Statutory Text Encompasses Debts For Money Or Property Obtained By Deliberately Fraudulent Transfers

Section 523(a)(2)(A)'s surrounding text also readily applies to a debtor who receives property through what he knows to be an intentionally fraudulent transfer. The statute bars discharge of "any debt ... for money [or] property ... to the extent obtained by ... actual fraud." 11 U.S.C. § 523(a)(2)(A). "The most straightforward reading of § 523(a)(2)(A) is that it prevents discharge of 'any debt' respecting 'money, property, services, or ... credit' that the debtor has fraudulently obtained[.]" *Cohen*, 523 U.S. at 218 (citing *Field*, 516 U.S. at 61, 64, for the proposition that § 523(a)(2)(A) bars "discharge of debts 'resulting from' or 'traceable to' fraud").

A "debt" means any enforceable obligation, and the phrase "obtained by" requires that the defendant receive money or property *as a result of* his fraud. As discussed above, a transferee commits actual fraud by receiving money or property through a conveyance that he knows is designed to defraud creditors. *See supra*, Part I.B. Therefore, such a debtor "obtains" that "money or property" fraudulently, i.e., "by" "actual fraud," and § 523(a)(2)(A) consequently bars discharge of any resulting "debt."

While this statutory text is clear, two decisions of this Court further explicate the broad sweep of § 523(a)(2)(A), and its purpose to bar discharge of all debts arising from all forms of actual fraud.

1. In *Archer v. Warner*, this Court considered whether a debt created by a settlement agreement is

nondischargeable under § 523(a)(2)(A) where the underlying claims involve alleged fraud. 538 U.S. 314, 317-18 (2003). Some courts of appeals had found those debts dischargeable, notwithstanding § 523(a)(2)(A), because they viewed the settlement agreement as "a kind of 'novation'" that "replaced (1) an original potential debt ... for money obtained by fraud with (2) a new debt." *Id.* at 318. According to those courts, the "new debt" was dischargeable because it was "for money promised in a settlement contract," rather than "for money obtained by fraud." *Id.*

Archer repudiated this approach as inconsistent with the text and purpose of the discharge bar, which Congress enacted "to ensure that 'all debts arising out of' fraud are 'excepted from discharge,' no matter what their form." *Id.* at 321 (quoting *Brown*, 442 U.S. at 138). Because Congress intended "the fullest possible inquiry" to identify debts arising from fraud, even an agreement that "worked a kind of novation" would "not bar" creditors "from showing that the [underlying] debt arose out of 'false pretenses, a false representation, or actual fraud,' and consequently is nondischargeable." *Id.* at 321, 323. Thus, *Archer* rejected the argument that "a debt for money promised in [a] settlement agreement" cannot "*also* amount to a debt for *money obtained by fraud*." *Id.* at 319 (emphasis added).

The Court later expanded upon these principles in *Cohen*, which held that § 523(a)(2)(A) "prohibit[s] the discharge of *any* liability arising from a debtor's fraudulent acquisition of money, property, etc., including an award of treble damages for the fraud." 523 U.S. at 221 (emphasis added). The debtor in

Cohen was a landlord who overcharged his tenants for rent, thereby violating a local rent-control ordinance. *Id.* at 215. After failing to obey a court order to refund the overpayments, the landlord declared bankruptcy and sought to discharge the debt. *See id.* The bankruptcy court held that his debt was nondischargeable under § 523(a)(2)(A) because the landlord had committed "actual fraud." *Id.* It further determined that his conduct was "an unconscionable commercial practice" under state law and awarded the tenants treble damages. *Id.* at 215-16. Explaining that "§ 523(a)(2)(A) encompasses all obligations arising out of fraudulent conduct," the bankruptcy court concluded that the punitive damages were nondischargeable. *Id.* at 216.

This Court agreed. It first considered whether a punitive damages award constitutes a "debt" under § 523. *Id.* at 218. A debt, *Cohen* explained, "is defined in the Code as 'liability on a claim,' a 'claim' is defined in turn as a 'right to payment,' and a 'right to payment,' ... is nothing more nor less than an enforceable obligation." *Id.* (citing 11 U.S.C. §§ 101(12), 101(5)(A); *Pa. Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 559 (1990)). These definitions "reflect Congress' broad view of the class of obligations that qualify as a 'claim' giving rise to a 'debt,'" and *Cohen* concluded that "they plainly encompass treble damages": "An award of treble damages is an 'enforceable obligation' of the debtor, and the creditor has a corresponding 'right to payment.'" *Id.*

Cohen further held that the debt at issue was for money or property "obtained by fraud." *Id.* at 218-19. This language does not require the debt *itself* to have

been obtained by fraud. *See id.* at 218 ("'To the extent obtained by' modifies 'money, property, services, or credit'—not 'any debt[.]'"). Nor does the phrase "obtained by" restrict the scope of the discharge bar to "the *value* of the money, property, or services *received* by the debtor." *Id.* at 219 (emphasis added).

Instead, "obtained by" requires causation—that the debtor's fraudulent conduct has caused him to obtain money or property. *See id.* at 218. And "[o]nce it is established that specific money or property has been obtained by fraud," then "'any debt' arising therefrom is excepted from discharge." *Id.* Emphasizing Congress's concern with protecting victims of fraud and making them "whole," *Cohen* rejected the notion that § 523(a)(2)(A) "impos[es] a restitutionary ceiling on the extent to which a debtor's liability is nondischargeable" such that a debtor could "discharge any liability for losses caused by his fraud in excess of the amount he initially received," or "obtained by" the fraud. *Id.* at 219, 223. Thus, *Cohen* held that punitive damages awarded on account of a debtor's fraudulent acquisition of money were nondischargeable, even though the punitive damages were not themselves money that the debtor obtained through fraud. *Id.* at 215.

2. These decisions reaffirm what the statute already makes clear: Section 523(a)(2)(A)'s language encompasses debts for money or property obtained through transfers that the recipient knows to be fraudulent.

Cohen and *Archer* show that, where a debtor's fraud causes him to receive money or property, any

resulting liability is a debt for money or property "obtained by" fraud. The phrase "obtained by" fraud means that the debtor's fraudulent conduct causes him to obtain the money or property at issue. *See Cohen*, 523 U.S. at 218-19, 222-23; *see also Archer*, 538 U.S. at 319. A party who receives property through a transfer that he knows is intended to defraud creditors commits actual fraud, *see supra*, Part I.B., and therefore has obtained such property by actual fraud. Moreover, there is no question that the creditor's loss is caused by the intentionally fraudulent conveyance. *Cf. Cohen*, 523 U.S. at 222-23.

These cases also confirm that "debt" is construed broadly to mean "any liability arising from a debtor's fraudulent acquisition of money, property, etc." *Id.* at 220-21; *see Archer*, 538 U.S. at 321. Knowing participation in a deliberately fraudulent transfer is a form of fraud that results in liability for the transferee. *See supra*, Part I.B. That resulting liability is an "enforceable obligation," and the creditor has a "corresponding right to payment," *Cohen*, 523 U.S. at 218 (internal quotation marks omitted). The term "debt" thus "plainly encompass[es]" all liability resulting from the knowing receipt of an intentionally fraudulent transfer. *See id.*

C. Interpreting Actual Fraud According To Its Common-Law Meaning Is Consistent With The Purposes Of The Bankruptcy Code

Construing "actual fraud" under § 523(a)(2)(A) to encompass any intentional fraud, not merely forms of

fraud that involve misrepresentations, is also consistent with the Bankruptcy Code's "basic policy" of "affording relief only to an 'honest but unfortunate debtor.'" *Cohen*, 523 U.S. at 217 (quoting *Grogan*, 498 U.S. at 287); *see Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 367 (2007); *Brown*, 442 U.S. at 128. A bankrupt debtor who receives property in a deliberate fraudulent transfer, knowing of the transferor's intent to defraud creditors, blatantly abuses the Bankruptcy Code. Congress did not intend to reward such behavior; to the contrary, by the plain terms of § 523(a)(2)(A), "Congress concluded that preventing fraud is more important than letting defrauders start over with a clean slate." *McClellan*, 217 F.3d at 893 (citation and quotation marks omitted).

1. "No bankruptcy bill can be, or ought to be, framed for the benefit of thieves and scoundrels, but for honest creditors and honest debtors." H.R. Rep. No. 55-65, at 43 (1897). Congress therefore has long been concerned with protecting bankruptcy from becoming an "engine of fraud and corruption." Cong. Globe, 39th Cong., 2d Sess. 998, 1012 (1867) (statement of Sen. Cowan). Indeed, when debating the Bankruptcy Act of 1867, some members of Congress believed that earlier attempts at bankruptcy legislation had failed because they "did not provide as strictly as [they] ought to have done against fraud." *Id.* at 1004 (statement of Sen. Poland). Accordingly, Congress wrote the 1867 Act to ensure that "no party" would be "entitled to [its] benefit[s] ... unless he can show that he has been perfectly innocent of all fraud." Cong. Globe, 39th Cong., 2d Sess. 975, 981 (1867) (statement of Sen.

Johnson). Among other things, Congress provided that "*no* discharge shall be granted, or, if granted, be valid, if the bankrupt ... has been guilty of any fraud whatever contrary to the true intent of this act." Ch. 176, § 29, 14 Stat. 517, 532 (1867) (emphasis added).

When Congress sought to modernize the Bankruptcy Act in 1898, it remained concerned about creating a system in which "the honest debtor will be treated with consideration and within a reasonable time be discharged," but "the dishonest bankrupt will be explicitly charged with his wrongdoing." 31 Cong. Rec. 1754, 1788 (1898); *see* 31 Cong. Rec. 6401, 6434 (1898) (statement of Rep. Ray) ("[I]t is absolutely essential that we guard against frauds and so frame our law that dishonest men shall not have the benefits of it."). This "wise public policy" animated the Act's bar of "[d]ischarges from debts created by wrongs, frauds, etc." H.R. Rep. No. 55-65 at 43; 31 Cong. Rec. at 6428; *see* Ch. 541, § 17(a)(2), 30 Stat. at 550 (barring discharge of "debts" that "are judgments in actions for frauds, or obtaining property by false pretenses or false representations, or for willful and malicious injuries to the person or property of another").

The current version of the Code continues to embody this "basic policy ... of affording relief only to an 'honest but unfortunate debtor.'" *Cohen*, 523 U.S. at 217 (quoting *Grogan*, 498 U.S. at 287). Congress accordingly enacted a broad discharge bar that encompasses a range of wrongdoing. *See supra* at 2-3. Specifically, § 523(a)(2)(A) reflects Congress's judgment that the interest of defrauded creditors in "being made whole" "outweighs the debtors' interest in a complete fresh start." *Cohen*, 523 U.S. at 222

(internal quotation marks omitted). Moreover, when Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, it extended § 523(a)(2)(A)'s discharge bar to apply to debtors in Chapter 13 cases. Pub. L. No. 109-8, § 314(b), 119 Stat. 23, 88 (2005). That change was part of a broader effort "to remedy certain types of fraud and abuse within the [Bankruptcy Code]." H.R. Rep. No. 109-31, at 15 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 101.

2. Interpreting § 523(a)(2)(A) to bar discharge of debts resulting from intentional fraud, regardless of whether the fraud takes the form of a misrepresentation, is consistent with this longstanding policy.

Deliberately fraudulent transfer schemes strike at the heart of Congress's concern about fraud. These schemes create the potential for a "two-step routine ... in which Debtor A transfers valuable property to B for nothing in order to keep it out of the hands of A's creditor and B then sells the property and declares bankruptcy in an effort to shield herself from liability for having colluded with A to defeat the rights of A's creditor." *McClellan*, 217 F.3d at 893. As both the First and Seventh Circuits concluded, such collusion to defraud creditors "is as blatant an abuse of the Bankruptcy Code as [one] can imagine." *Id.*; *see Lawson*, 791 F.3d at 224. Permitting such behavior would "turn[] the bankruptcy code into an engine for fraud." *McClellan*, 217 F.3d at 893; *see Lawson*, 791 F.3d at 224. That would contravene the purpose underlying the Bankruptcy Code as a whole, and the specific objective of § 523(a)(2)(A).

This Court has repeatedly rejected narrow constructions of § 523(a)(2)(A) that would thwart Congress's purpose to afford relief for only the *honest* but unfortunate debtor. *See Cohen*, 523 U.S. at 222-23; *Grogan*, 498 U.S. at 287; *Brown*, 442 U.S. at 128; *see also Archer*, 538 U.S. at 321. It should do the same here.

III. THE FIFTH CIRCUIT WAS WRONG TO HOLD THAT ACTUAL FRAUD CATEGORICALLY REQUIRES A MISREPRESENTATION

The Fifth Circuit held that a misrepresentation is a "necessary prerequisite" to actual fraud under § 523(a)(2)(A). Pet. App. 17a; *see* Pet. App. 12a. The Fifth Circuit's reasons do not withstand scrutiny.

A. The Fifth Circuit Misread *Field*

The Fifth Circuit based its holding primarily on its misreading of this Court's decision in *Field*. In fact, *Field* is relevant here only because its methodology establishes that *not* all forms of actual fraud categorically require a misrepresentation. *Field* explained that actual fraud should be understood by reference to the common law in 1978, when that term was added to § 523(a)(2)(A). *See* 516 U.S. at 69. As explained above, and as both the First and Seventh Circuits recognized, the common-law understanding of actual fraud in 1978 encompassed deliberate fraudulent-transfer schemes. *See Lawson*, 791 F.3d at 220; *McClellan*, 217 F.3d at 893; *supra*, Part I.B.

The Fifth Circuit nevertheless said that "*Field* appeared to assume that a false representation is necessary to establish 'actual fraud.'" Pet. App. 10a. As *McClellan* explained, however, the particular type

of fraud in *Field* "took the form of a misrepresentation, and the only issue was the nature of [the creditor's] reliance" on the misrepresentation that was required "to prove fraud *in such a case*." 217 F.3d at 892 (emphasis added). "Nothing in [this] Court's opinion suggests that misrepresentation is the *only* type of fraud that can give rise to a debt that is not dischargeable under section 523(a)(2)(A)." *Id.* (emphasis added).

Specifically, the debtor, Field, purchased land with a promissory note that was secured by a second mortgage. 516 U.S. at 61. The mortgage deed gave the sellers a right to demand the entire balance on the note if Field conveyed the land without first obtaining their consent. *Id.* at 62. A few months later, Field transferred the land without telling the sellers or seeking their consent. *Id.* Instead, he sent them a letter saying that he was considering conveying the property and asking them to waive the due-on-sale clause prospectively. *Id.* The sellers refused. But based on Field's false representation that he was merely considering a conveyance, and his failure to disclose that he had already conveyed the land, they did not demand immediate payment on the note. *See id.* at 62-63. When Field later filed for bankruptcy, the sellers argued that his debt on the note was nondischargeable under § 523(a)(2)(A) because, they argued, he defrauded them into extending him additional credit (i.e., not enforcing the due-on-sale clause immediately) based on his misrepresentation. *Id.*

The only form of fraud alleged in *Field*, and the only basis asserted for nondischargeability, was therefore Field's misrepresentation to his creditors.

And the only issue that this Court faced was, in a case that indisputably involved a misrepresentation, "the level of a creditor's reliance on [the] fraudulent misrepresentation necessary to place a debt ... beyond release." *Id.* at 61. After all, if the sellers did not rely on the misrepresentation to extend credit, then the misrepresentation could not have caused their loss, *see* Restatement (Second) Torts § 546, and Field could not have obtained anything by fraud. And if, as the Fifth Circuit surmised, "the debt at issue would not have been dischargeable absent a representation," Pet. App. 10a n.8, that is only because there was no *other* fraudulent conduct alleged apart from a misrepresentation. *Field* did not speak to whether other types of fraud require a misrepresentation.

B. Interpreting Actual Fraud According To Its Common-Law Meaning Does Not Render Other Provisions Of The Bankruptcy Code Superfluous

The Fifth Circuit also suggested in passing that other provisions of the Bankruptcy Code "may be rendered redundant" by Husky's reading of § 523(a)(2)(A). Pet App. 16a. That concern is unfounded.

1. The Fifth Circuit first noted that "[i]t would appear odd" for § 523(a)(2)(A) to extend beyond misrepresentations because the Bankruptcy Code contains a separate provision that excepts certain fraudulent transfers from discharge. Pet. App. 16a (citing 11 U.S.C. § 727(a)(2)). In relevant part, § 727(a)(2) provides that "[t]he court shall grant a discharge, unless ... the debtor, with intent to hinder,

delay, or defraud a creditor ... has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed ... property of the debtor ... or property of the estate." 11 U.S.C. § 727(a)(2).

Sections 523(a)(2)(A) and 727(a)(2) apply in different circumstances and serve different functions. Section 727(a)(2) applies only where the debtor diminishes the bankruptcy estate by *transferring property away* from the reach of its creditors. *See id.* That is, it applies only where the debtor is the *transferor* in a fraudulent transfer scheme. Unlike § 523(a)(2)(A), it does not apply to a debtor who is alleged to have *received* property as part of a fraudulent scheme. *See, e.g.*, *Lawson*, 791 F.3d at 216 (debtor knowingly accepted conveyance designed to prevent creditor from collecting a judgment against her father); *McClellan*, 217 F.3d at 893 (debtor sold $200,000 worth of machinery that she had purchased for $10 from insolvent brother).

Moreover, when they do apply, §§ 523(a)(2)(A) and 727(a)(2) have different consequences and purposes. Unlike § 727, which blocks a debtor's ability to obtain a discharge of any debts whatsoever, § 523 is targeted more narrowly at the discharge of particular debts. Thus, a debtor who violates § 727 is ineligible for any discharge, while a debtor who violates § 523 is ineligible to discharge only those debts that have been specifically tainted by fraud. In addition, § 727(a)(2) applies only to Chapter 7 cases, and therefore makes it a poor vehicle for protecting victims of fraud. *See* 11 U.S.C. § 103(b). Section § 523(a)(2)(A), by contrast, applies to debtors in both Chapter 7 and Chapter 13 cases. *See* 11 U.S.C.

§§ 727(b), 1328(a)(2). Congress chose to make all victims of fraud whole through the discharge bar, not merely victims of debtors in Chapter 7 proceedings.

2. The Fifth Circuit also wrongly concluded that two "other exceptions to discharge in [§ 523(a)] may be rendered redundant" by Husky's reading of actual fraud: Section 523(a)(4), which excepts debts "for fraud or defalcation while acting in a fiduciary capacity," and § 523(a)(6), which excepts debts "for willful and malicious injury by the debtor," Pet. App. 16a (citing 11 U.S.C. § 523(a)(4), (a)(6)). But contrary to the Fifth Circuit's reasoning, both of these provisions differ in scope from § 523(a)(2)(A)'s actual fraud provision. And to the extent that there is any overlap, it is a function of Congress's drafting rather than of any particular definition of actual fraud.

a. Interpreting actual fraud according to its common-law meaning will not render § 523(a)(4)'s fiduciary fraud and defalcation provisions redundant. As this Court observed in *Bullock v. BankChampaign, N.A.*, defalcation and fraud cover different types of conduct. *See* 133 S. Ct. 1754, 1760 (2013) ("'[D]efalcation,' unlike 'fraud,' may be used to refer to *nonfraudulent* breaches of fiduciary duty."). And the *fiduciary* fraud covered by § 523(a)(4) is both narrower and broader than "actual fraud" under § 523(a)(2)(A). Fraud in a fiduciary capacity, by definition, applies only when the debtor owes a fiduciary duty to another party, and thus reaches a narrower range of conduct than actual fraud. *See id.* However, because fiduciaries owe a heightened duty of care, *see* Restatement (Second) Trusts §§ 169-85 (1959) (duties of trustee), some conduct may be fraudulent only if done in a fiduciary capacity, *see,*

e.g., Restatement (Second) Torts § 551(2)(a) (fiduciary duty to disclose information gives rise to actionable misrepresentation, even though same conduct by non-fiduciary may not be actionable). In any event, any overlap between § 523(a)(2)(A)'s actual fraud bar and § 523(a)(4)'s fiduciary fraud bar is a function of Congress's decision to include the word "fraud" in both provisions—not of any particular interpretation of actual fraud.

b. Nor does Husky's interpretation of actual fraud render § 523(a)(6) superfluous. Section 523(a)(6) extends to "intentional torts" involving "willful and malicious injury" that do not involve any type of "fraud" at all, such as assaulting someone or setting his car on fire. *See Kawaauhau v. Geiger*, 523 U.S. 57, 61-62 (1998). For this reason alone, the Fifth Circuit's concern that § 523(a)(2)(A) would render § 523(a)(6) redundant is unfounded.

Moreover, unlike § 523(a)(2)(A), which applies in *all* Chapter 13 cases, § 523(a)(6) does not apply in most Chapter 13 cases. *See* 11 U.S.C. § 1328(a)(2); *Lawson*, 791 F.3d at 223 & n.13. Thus, under the Fifth Circuit's interpretation, "especially clever" debtors would be able to defraud their victims through deliberate fraudulent-transfer schemes, and then avoid any discharge bar by filing for bankruptcy under Chapter 13 instead of Chapter 7. *Lawson*, 791 F.3d at 224. Congress—having extended § 523(a)(2)(A) to Chapter 13 in 2005 amendments to the Bankruptcy Code precisely to remedy fraud and abuse in bankruptcy, *see supra* at 46—could not possibly have intended that result.

C. Congress Has Determined That Only Honest Debtors Are Entitled To A Fresh Start

Finally, the Fifth Circuit reasoned that § 523(a)(2)(A) should be construed narrowly to give debtors a "fresh start." Pet. App. 16a (internal quotation marks omitted). That policy, however, "provides little assistance in construing a section expressly designed to make some debts nondischargeable." *United States v. Sotelo*, 436 U.S. 268, 280 (1978). As this Court has explained, a provision like § 523 "is not a compassionate section for debtors" because "it demonstrates congressional judgment that certain problems ... override the value of giving the debtor a wholly fresh start." *Bruning v. United States*, 376 U.S. 358, 361 (1964) (construing § 523's predecessor). Thus, where, as here, the debt arises from actual fraud, Congress has already determined that the interest of defrauded creditors in "being made whole" "outweighs the debtors' interest in a complete fresh start." *Cohen*, 523 U.S. at 222 (internal quotation marks omitted).

* * * * *

The Fifth Circuit erred in holding that a misrepresentation is categorically required to establish nondischargeability under § 523(a)(2)(A). Section 523(a)(2)(A) bars the discharge of any debt arising from "actual fraud," a term that includes receiving money or property in a transfer that the recipient knows is intended to defraud creditors. The Fifth Circuit never considered whether Husky established that Ritz's conduct met this standard because it found the lack of a misrepresentation

dispositive. Accordingly, Husky should have an opportunity to establish on remand that Ritz incurred a debt for money or property that he obtained by a deliberately fraudulent transfer.

CONCLUSION

For these reasons, the judgment below should be reversed, and the case should be remanded for further proceedings.

Respectfully submitted,

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STATUTORY ADDENDUM

11 U.S.C. § 523

§ 523. Exceptions to discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

(1) for a tax or a customs duty—

(A) of the kind and for the periods specified in section 507(a)(3) or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed;

(B) with respect to which a return, or equivalent report or notice, if required—

(i) was not filed or given; or

(ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or

(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax;

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

(B) use of a statement in writing—

(i) that is materially false;

(ii) respecting the debtor's or an insider's financial condition;

(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and

(iv) that the debtor caused to be made or published with intent to deceive; or

(C)(i) for purposes of subparagraph (A)—

(I) consumer debts owed to a single creditor and aggregating more than $650[1] for luxury goods or services incurred by an individual debtor on or within 90 days before the order for relief under this title are presumed to be nondischargeable; and

(II) cash advances aggregating more than $925 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 70 days before the order for relief under this title, are presumed to be nondischargeable; and

(ii) for purposes of this subparagraph—

(I) the terms "consumer", "credit", and "open end credit plan" have the same meanings as in section 103 of the Truth in Lending Act; and

(II) the term "luxury goods or services" does not include goods or services reasonably necessary for the support or maintenance of the debtor or a dependent of the debtor;

(3) neither listed nor scheduled under section 521(a)(1) of this title, with the name, if known to

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[1] Dollar amount as adjusted by the Judicial Conference of the United States. See Adjustment of Dollar Amounts notes set out under this section and 11 U.S.C.A. § 104.

the debtor, of the creditor to whom such debt is owed, in time to permit—

(A) if such debt is not of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim, unless such creditor had notice or actual knowledge of the case in time for such timely filing; or

(B) if such debt is of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim and timely request for a determination of dischargeability of such debt under one of such paragraphs, unless such creditor had notice or actual knowledge of the case in time for such timely filing and request;

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

(5) for a domestic support obligation;

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity;

(7) to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty—

(A) relating to a tax of a kind not specified in paragraph (1) of this subsection; or

(B) imposed with respect to a transaction or event that occurred before three years before the date of the filing of the petition;

(8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for—

(A)(i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or

(ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or

(B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual;

(9) for death or personal injury caused by the debtor's operation of a motor vehicle, vessel, or aircraft if such operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance;

(10) that was or could have been listed or scheduled by the debtor in a prior case concerning the debtor under this title or under the Bankruptcy Act in which the debtor waived discharge, or was denied a discharge under section 727(a)(2), (3), (4), (5), (6), or (7) of this title, or under section 14c(1), (2), (3), (4), (6), or (7) of such Act;

(11) provided in any final judgment, unreviewable order, or consent order or decree entered in any court of the United States or of any State, issued by a Federal depository institutions regulatory agency, or contained in any settlement agreement entered into by the debtor, arising from any act of fraud or defalcation while acting in a fiduciary capacity committed with respect to any depository institution or insured credit union;

(12) for malicious or reckless failure to fulfill any commitment by the debtor to a Federal depository institutions regulatory agency to maintain the capital of an insured depository institution, except that this paragraph shall not extend any such commitment which would otherwise be terminated due to any act of such agency;
(13) for any payment of an order of restitution issued under title 18, United States Code;
(14) incurred to pay a tax to the United States that would be nondischargeable pursuant to paragraph (1);
(14A) incurred to pay a tax to a governmental unit, other than the United States, that would be nondischargeable under paragraph (1);
(14B) incurred to pay fines or penalties imposed under Federal election law;
(15) to a spouse, former spouse, or child of the debtor and not of the kind described in paragraph (5) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record, or a determination made in accordance with State or territorial law by a governmental unit;
(16) for a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a unit that has condominium ownership, in a share of a cooperative corporation, or a lot in a homeowners association, for as long as the debtor or the trustee has a legal, equitable, or possessory ownership interest in such unit, such corporation, or such lot, but nothing in this paragraph shall

except from discharge the debt of a debtor for a membership association fee or assessment for a period arising before entry of the order for relief in a pending or subsequent bankruptcy case;

(17) for a fee imposed on a prisoner by any court for the filing of a case, motion, complaint, or appeal, or for other costs and expenses assessed with respect to such filing, regardless of an assertion of poverty by the debtor under subsection (b) or (f)(2) of section 1915 of title 28 (or a similar non-Federal law), or the debtor's status as a prisoner, as defined in section 1915(h) of title 28 (or a similar non-Federal law);

(18) owed to a pension, profit-sharing, stock bonus, or other plan established under section 401, 403, 408, 408A, 414, 457, or 501(c) of the Internal Revenue Code of 1986, under—

(A) a loan permitted under section 408(b)(1) of the Employee Retirement Income Security Act of 1974, or subject to section 72(p) of the Internal Revenue Code of 1986; or

(B) a loan from a thrift savings plan permitted under subchapter III of chapter 84 of title 5, that satisfies the requirements of section 8433(g) of such title;

but nothing in this paragraph may be construed to provide that any loan made under a governmental plan under section 414(d), or a contract or account under section 403(b), of the Internal Revenue Code of 1986 constitutes a claim or a debt under this title; or

(19) that—

(A) is for—

(i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934), any of the State securities laws, or any regulation or order issued under such Federal or State securities laws; or

(ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and

(B) results, before, on, or after the date on which the petition was filed, from—

(i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;

(ii) any settlement agreement entered into by the debtor; or

(iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.

For purposes of this subsection, the term "return" means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such term includes a return prepared pursuant to section 6020(a) of the Internal Revenue Code of 1986, or similar State or local law, or a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal, but does not include a return made pursuant to section 6020(b) of

the Internal Revenue Code of 1986, or a similar State or local law.

(b) Notwithstanding subsection (a) of this section, a debt that was excepted from discharge under subsection (a)(1), (a)(3), or (a)(8) of this section, under section 17a(1), 17a(3), or 17a(5) of the Bankruptcy Act, under section 439A of the Higher Education Act of 1965, or under section 733(g) of the Public Health Service Act in a prior case concerning the debtor under this title, or under the Bankruptcy Act, is dischargeable in a case under this title unless, by the terms of subsection (a) of this section, such debt is not dischargeable in the case under this title.

(c)(1) Except as provided in subsection (a)(3)(B) of this section, the debtor shall be discharged from a debt of a kind specified in paragraph (2), (4), or (6) of subsection (a) of this section, unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2), (4), or (6), as the case may be, of subsection (a) of this section.

(2) Paragraph (1) shall not apply in the case of a Federal depository institutions regulatory agency seeking, in its capacity as conservator, receiver, or liquidating agent for an insured depository institution, to recover a debt described in subsection (a)(2), (a)(4), (a)(6), or (a)(11) owed to such institution by an institution-affiliated party unless the receiver, conservator, or liquidating agent was appointed in time to reasonably comply, or for a Federal depository institutions regulatory agency acting in its corporate capacity as a successor to such receiver, conservator, or

liquidating agent to reasonably comply, with subsection (a)(3)(B) as a creditor of such institution-affiliated party with respect to such debt.

(d) If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

(e) Any institution-affiliated party of an insured depository institution shall be considered to be acting in a fiduciary capacity with respect to the purposes of subsection (a)(4) or (11).

11 U.S.C. § 727

§ 727. Discharge

(a) The court shall grant the debtor a discharge, unless—

(1) the debtor is not an individual;

(2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed—

(A) property of the debtor, within one year before the date of the filing of the petition; or

(B) property of the estate, after the date of the filing of the petition;

(3) the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case;

(4) the debtor knowingly and fraudulently, in or in connection with the case—

(A) made a false oath or account;

(B) presented or used a false claim;

(C) gave, offered, received, or attempted to obtain money, property, or advantage, or a promise of money, property, or advantage, for acting or forbearing to act; or

(D) withheld from an officer of the estate entitled to possession under this title, any

recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs;

(5) the debtor has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities;

(6) the debtor has refused, in the case—

(A) to obey any lawful order of the court, other than an order to respond to a material question or to testify;

(B) on the ground of privilege against self-incrimination, to respond to a material question approved by the court or to testify, after the debtor has been granted immunity with respect to the matter concerning which such privilege was invoked; or

(C) on a ground other than the properly invoked privilege against self-incrimination, to respond to a material question approved by the court or to testify;

(7) the debtor has committed any act specified in paragraph (2), (3), (4), (5), or (6) of this subsection, on or within one year before the date of the filing of the petition, or during the case, in connection with another case, under this title or under the Bankruptcy Act, concerning an insider;

(8) the debtor has been granted a discharge under this section, under section 1141 of this title, or under section 14, 371, or 476 of the Bankruptcy Act, in a case commenced within 8 years before the date of the filing of the petition;

(9) the debtor has been granted a discharge under section 1228 or 1328 of this title, or under

section 660 or 661 of the Bankruptcy Act, in a case commenced within six years before the date of the filing of the petition, unless payments under the plan in such case totaled at least—

(A) 100 percent of the allowed unsecured claims in such case; or

(B)(i) 70 percent of such claims; and

(ii) the plan was proposed by the debtor in good faith, and was the debtor's best effort;

(10) the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter;

(11) after filing the petition, the debtor failed to complete an instructional course concerning personal financial management described in section 111, except that this paragraph shall not apply with respect to a debtor who is a person described in section 109(h)(4) or who resides in a district for which the United States trustee (or the bankruptcy administrator, if any) determines that the approved instructional courses are not adequate to service the additional individuals who would otherwise be required to complete such instructional courses under this section (The United States trustee (or the bankruptcy administrator, if any) who makes a determination described in this paragraph shall review such determination not later than 1 year after the date of such determination, and not less frequently than annually thereafter.); or

(12) the court after notice and a hearing held not more than 10 days before the date of the entry of the order granting the discharge finds that there is reasonable cause to believe that—

(A) section 522(q)(1) may be applicable to the debtor; and

(B) there is pending any proceeding in which the debtor may be found guilty of a felony of the kind described in section 522(q)(1)(A) or liable for a debt of the kind described in section 522(q)(1)(B).

(b) Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order for relief under this chapter, and any liability on a claim that is determined under section 502 of this title as if such claim had arisen before the commencement of the case, whether or not a proof of claim based on any such debt or liability is filed under section 501 of this title, and whether or not a claim based on any such debt or liability is allowed under section 502 of this title.

(c)(1) The trustee, a creditor, or the United States trustee may object to the granting of a discharge under subsection (a) of this section.

(2) On request of a party in interest, the court may order the trustee to examine the acts and conduct of the debtor to determine whether a ground exists for denial of discharge.

(d) On request of the trustee, a creditor, or the United States trustee, and after notice and a hearing, the court shall revoke a discharge granted under subsection (a) of this section if—

(1) such discharge was obtained through the fraud of the debtor, and the requesting party did not know of such fraud until after the granting of such discharge;

(2) the debtor acquired property that is property of the estate, or became entitled to acquire property that would be property of the estate, and knowingly and fraudulently failed to report the acquisition of or entitlement to such property, or to deliver or surrender such property to the trustee;

(3) the debtor committed an act specified in subsection (a)(6) of this section; or

(4) the debtor has failed to explain satisfactorily—

(A) a material misstatement in an audit referred to in section 586(f) of title 28; or

(B) a failure to make available for inspection all necessary accounts, papers, documents, financial records, files, and all other papers, things, or property belonging to the debtor that are requested for an audit referred to in section 586(f) of title 28.

(e) The trustee, a creditor, or the United States trustee may request a revocation of a discharge—

(1) under subsection (d)(1) of this section within one year after such discharge is granted; or

(2) under subsection (d)(2) or (d)(3) of this section before the later of—

(A) one year after the granting of such discharge; and

(B) the date the case is closed.

No. 15-145

In the
Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC.,
Petitioner,
v.
DANIEL LEE RITZ, JR.,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR RESPONDENT

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QUESTION PRESENTED

The Bankruptcy Code excepts from discharge "any debt ... for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by ... false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." 11 U.S.C. §523(a)(2)(A). The question presented is whether this provision applies when the debtor concededly made no misrepresentation that induced the putative creditor to turn over any money, property, services, or credit, and instead is alleged only to have participated in a transaction that aided a third party in evading that party's preexisting debts to that creditor.

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INTRODUCTION

This case concerns the Bankruptcy Code's exception from discharge for "any debt ... for money, property, services, or ... credit, to the extent obtained by ... false pretenses, a false representation, or actual fraud." 11 U.S.C. §523(a)(2)(A). That exception is not, as respondent claims, a catchall for any debt attributable to any conduct that conceivably might be described as "intended to defraud." Instead, the section 523(a)(2)(A) exception is directed at a specific kind of debt: a debt for money, property, services, or credit with which the debtor fraudulently induced the creditor to part. In other words, the exception is directed only at debts that are the product of a misrepresentation that induced the creditor to part with whatever it is that gave rise to the debt.

That is clear not only from the statute's explicit and repeated references to false words or acts, but also from its application to debts for things "obtained by" the conduct that it enumerates. As this Court held in *Field v. Mans*, "some degree of *reliance* is required to satisfy the element of causation inherent in the phrase 'obtained by,'" 516 U.S. 59, 66 (1995) (emphasis added)—a phrase found in none of the code's other exceptions. And a creditor cannot establish reliance without first establishing the misrepresentation that induced it. The statute itself thus confirms that section 523(a)(2)(A) incorporates the ordinary understanding of common-law fraud: a knowingly false or misleading word or act used to induce the victim's detrimental reliance.

Congress' inclusion of the phrase "actual fraud" in section 523(a)(2)(A) does not do away with those

essential elements. As petitioner concedes, the term "actual fraud" "has nothing to do with whether the fraud involves a misrepresentation." Pet'r.Br.15. Instead, it "refers to the perpetrator's *mindset*"—*i.e.*, whether the perpetrator *intended* his conduct to injure the victim. Pet'r.Br.19 (emphasis added). The cases on which petitioner relies use the term in that very sense, treating "actual fraud" as a shorthand for scienter, not as a particular type of conduct.

That is precisely how Congress used the term in section 523(a)(2)(A): to confirm that the exception applies only to debts for things induced by intentional, not "constructive" or "implied," fraud. The "actual fraud" language thus does not expand section 523(a)(2)(A) at all; instead, it serves to narrow the exception, by requiring the creditor to prove that the debtor made the misrepresentation with actual intent to induce the creditor to part with its money, property, services, or credit. Here, it is conceded that respondent did not make any misrepresentation that induced petitioner to part with anything. In fact, it is undisputed that respondent obtained nothing from petitioner at all. The courts below thus correctly concluded that petitioner failed to prove the existence of "any debt ... for money, property, services, or ... credit ... obtained by ... false pretenses, a false representation, or actual fraud." 11 U.S.C. §523(a)(2)(A).

That does not mean, as petitioner suggests, that the Bankruptcy Code contains some sort of "carve out" for the type of intentional wrongdoing alleged (albeit not proven) here. In fact, conduct that injures a creditor, but not through a misrepresentation that

induced it to part with money, property, services, or credit, is dealt with in several provisions of the code—including other exceptions from discharge. Petitioner invoked one of those exceptions (the exception for "willful and malicious injury" to the creditor) in this very case. Its efforts did not fail because the courts below found that exception inapplicable as a matter of law. They failed because the courts below found that petitioner failed to prove that respondent engaged in any misconduct *intended* to injure petitioner. That not only means that petitioner cannot prevail even under its own reading of section 523(a)(2)(A), but also confirms that the Bankruptcy Code already has ample means of dealing with debts attributable to so-called "fraudulent conveyances." Petitioner's attempt to add section 523(a)(2)(A) to that list is nothing more than an ill-concealed effort to rescue itself from the consequences of having failed to prove its case.

STATEMENT OF THE CASE

A. Statutory Background

1. "The Bankruptcy Code provides diverse courses overburdened debtors may pursue to gain discharge of their financial obligations, and thereby a 'fresh start.'" *Harris v. Viegelahn*, 135 S. Ct. 1829, 1835 (2015). For an individual debtor, the choice is typically between Chapter 7 and Chapter 13. A Chapter 7 bankruptcy "allows a debtor to make a clean break from his financial past, but at a steep price: prompt liquidation of the debtor's assets." *Id.* Although the debtor's debts are discharged entirely, subject to certain specified exceptions, the debtor's pre-petition assets are lost entirely as well. Chapter 13, on the other hand, is a "wholly voluntary alternative to Chapter 7" that

"allows a debtor to retain his property if he proposes, and gains court confirmation of, a plan to repay his debts over a three- to-five year period." *Id.* Unlike under a Chapter 7 liquidation, "[p]ayments under a Chapter 13 plan are usually made from a debtor's 'future earnings or other future income.'" *Id.* (quoting 11 U.S.C. §1322(a)(1)). While Chapter 13 does not demand that a debtor give up all of his pre-petition assets, it also does not provide the same immediate "clean break" as Chapter 7. Discharge instead comes only after the debtor has completed a plan for paying off his debts.

The Bankruptcy Code has long imposed certain bars to discharge, some of which are absolute, and some of which apply only to except particular debts from discharge. As for the former, the code categorically denies discharge to a debtor who uses fraudulent transfers or other acts to conceal his assets and prevent his creditors from collecting on their debts. Specifically, it denies discharge to any debtor who,

> with intent to hinder, delay, or defraud a creditor or ... the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed—
>
> (A) property of the debtor, within one year before the date of the filing of the petition; or
>
> (B) property of the estate, after the date of the filing of the petition[.]

11 U.S.C. §727(a)(2).

The code also empowers the trustee of the estate to avoid transfers of the debtor's assets under certain specified circumstances. *Id.* §548(a)(1). Any transfer made "with actual intent to hinder, delay, or defraud a creditor" within two years of filing (rather than one-year requirement for section 727(a)(2)'s absolute bar) may be avoided, *id.* §548(a)(1)(A), and transfers during that timeframe also be may avoided without regard to the debtor's intent if they were made for "less than a reasonably equivalent value" and one of four other conditions is satisfied, *id.* §548(a)(1)(B). Through these provisions, Congress has spoken directly to situations in which a debtor attempts to use the Bankruptcy Code as a vehicle for evading his debts: In such situations, the transfers can be avoided and, in the most egregious cases, the debtor can be denied a discharge of all debts.

As to debtors who engaged in other forms of wrongdoing before declaring bankruptcy, Congress was not nearly so harsh. Instead of denying discharge entirely, the code excepts from discharge debts arising out of certain enumerated acts or circumstances. Accordingly, Congress still provides a "fresh start" to debtors who have committed acts such as "embezzlement[] or larceny," or "willful and malicious injury ... to another," *id.* §523(a)(4), (6); their fresh start just may not be quite as complete. Consistent with the ultimate goal of giving the debtor "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt," this Court has long held that these debt-specific exceptions to discharge must be construed narrowly. *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934); *see also, e.g., Bullock v.*

BankChampaign, N.A., 133 S. Ct. 1754, 1760 (2013); *Kawaauhau v. Geiger*, 523 U.S. 57, 62 (1998); *Gleason v. Thaw*, 236 U.S. 558, 562 (1915).

2. This case concerns the exception to discharge found in section 523(a)(2)(A), which excepts "any debt—(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." 11 U.S.C. §523(a)(2)(A). Section 523(a)(2)(A) has its origins in the 1867 bankruptcy statute, which excepted from discharge any "debt created by the fraud or embezzlement of the bankrupt." Act of Mar. 2, 1867, ch.76, §33, 14 Stat. 517, 533 ("1867 Act"). Invoking the "liberal spirit which pervades the entire bankruptcy system," this Court early on held that "the 'fraud' referred to in that section means positive fraud, or fraud in fact, involving moral turpitude or intentional wrong, as does embezzlement; and not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality." *Neal v. Clark*, 95 U.S. 704, 707, 709 (1877). In other words, the Court held that the exception referred only to "actual fraud," not "constructive fraud." *Id.*

Although the term "actual fraud" dates back to *Neal* and cases before it, Congress did not add that term to the Bankruptcy Code for another century. Instead, in 1898, Congress narrowed the fraud exception by confining it to debts for "*judgments* in actions for frauds, or obtaining property by false pretenses or false representations, or for willful and

malicious injuries to the person or property of another." Act of July 1, 1898, ch.541, §17a(2), 30 Stat. 544, 550 ("1898 Act") (emphasis added). As this Court explained, that revision meant that "claims grounded in fraud will not be exempted unless reduced to judgment." *Bullis v. O'Beirne*, 195 U.S. 606, 619 (1904). In the 1898 Act, Congress also included a separate subsection excepting from discharge debts "created by [the debtor's] fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity." 1898 Act §17a(4), 30 Stat. at 550-51.

In 1903, Congress removed the term "fraud" from section 17a(2) entirely and revised the provision to except "liabilities for obtaining property by false pretenses or false representations, or for willful and malicious injuries to the person or property of another." Act of Feb. 5, 1903, ch.487, §5, 32 Stat. 797, 798 ("1903 Act"). Congress retained the separate exception for "debts created by [a debtor's] fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity." *Id.* The accompanying House Judiciary Committee report offered no explanation for the deletion of "fraud" from subsection (2) of section 17a. *See* H.R. Rep. No. 57-1698, at 6 (1902). The report made clear, however, that the committee considered the phrase "false pretenses or false representations" coterminous with the "created by fraud" concept reflected in the 1867 Act and discussed in *Neal*: According to the report, the change from "judgment" to "liabilities" would ensure that "claims *created by fraud* but not reduced to judgment" would be excepted from discharge. *Id.* (emphasis added).

Consistent with that understanding, this Court continued to treat section 17a(2) as excepting from discharge debts "obtained by fraud." *Gleason*, 236 U.S. at 562. Because section 17a(2) applied only to "liabilities for obtaining *property* by false pretenses or false representations," however, the Court concluded that it could not reach debts for "liabilities incurred for *services* obtained by fraud." *Id.* (emphasis added). Congress subsequently amended section 17a(2) to add the term "money." *See* Chandler Act, Pub. L. No. 75-969, 52 Stat. 840, 851 (1938). For the next 40 years, these exceptions remained effectively unchanged, denying discharge of any "liabilities for obtaining money or property by false pretenses or false representations, or ... liabilities for willful and malicious injuries to the person or property of another." 11 U.S.C. §35(a) (1976).

3. When Congress enacted the modern Bankruptcy Code in 1978, it continued to deal with fraud in multiple exceptions from discharge. In what is now section 523(a)(2), Congress excepted from discharge any debt "for obtaining money, property, services, or an extension, renewal, or refinance of credit, by (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." Act of Nov. 6, 1978, Pub. L. No. 95-598, §101, 92 Stat. 2549, 2590 ("1978 Act") (codified at 11 U.S.C. §523(a)(2)(A)). In the same provision, Congress also excepted any debt "for obtaining money, property, services, or an extension, renewal, or refinance of credit, by" certain "materially false" writings that the debtor "made or published with intent to deceive," and "on which the creditor to whom the debtor is liable for such money,

property, services, or credit reasonably relied." *Id.* (codified at 11 U.S.C. §523(a)(2)(B)). In a separate provision of section 523(a), Congress continued to except any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." *Id.* §101, 92 Stat. at 2591 (codified at 11 U.S.C. §523(a)(4)). Congress also retained and moved to a separate provision the exception for any debt "for willful and malicious injury by the debtor to another entity or to the property of another entity." *Id.* (codified at 11 U.S.C. §523(a)(6)).

In 1984, Congress amended the fraud exception now found in section 523(a)(2) to add a new subsection (C) providing that, "for purposes of subparagraph (A), ... debts ... for luxury goods or services incurred by an individual debtor on or within forty days" or "cash advances ... obtained by an individual debtor on or within twenty days" of a bankruptcy filing are "presumed to be nondischargeable." Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, §307(a), 98 Stat. 333, 353 ("1984 Act"). In conjunction with these changes, Congress also made a "stylistic" change to section 523(a)(2)'s "obtaining" language. S. Rep. No. 98-65, at 80 (1983). It removed the word "obtaining" and added a materially identical qualifier limiting section 523(a)(2)'s application to debts "for money ..., to the extent obtained by" the conduct enumerated in subparagraphs (A) and (B). 1984 Act §454(a)(1)(B), 98 Stat. at 376.

The most relevant parts of section 523(a)(2) thus currently read:

> (a) A discharge ... does not discharge an individual debtor from any debt—
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.
>
> (B) use of a statement in writing—
>
> (i) that is materially false;
>
> (ii) respecting the debtor's or an insider's financial condition;
>
> (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
>
> (iv) that the debtor caused to be made or published with intent to deceive[.]

11 U.S.C. §523(a)(2)(A)-(B).

Section 523(a)(4) continues to except from discharge any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." *Id.* §523(a)(4). And section 523(a)(6) continues to except any debt "for willful and malicious injury by the debtor to another entity or to the property of another entity." *Id.* §523(a)(6).

4. In the 1978 version of the Bankruptcy Code, each of those exceptions applied in Chapter 7 proceedings, but not in Chapter 13 proceedings. In 2005, however, Congress revised the code to extend some (but not all) of the Chapter 7 exceptions to Chapter 13 cases. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. No. 109-8, §314, 119 Stat. 23, 88 (codified at 11 U.S.C. §1328(a)(2)). In particular, Congress applied section 523(a)(2) and 523(a)(4) to Chapter 13 cases, but not section 523(a)(6). *See* 11 U.S.C. §1328(a)(2). Debts "for willful and malicious injury by the debtor to another entity or to the property of another entity" therefore can be excepted from a Chapter 7 discharge, but not from a Chapter 13 discharge.

B. Proceedings Below

1. Factual Background

This case arises out of a Chapter 7 bankruptcy filed by respondent Daniel Ritz, an individual debtor. Before filing for bankruptcy, respondent was a director and partial owner of Chrysalis Manufacturing Corporation ("Chrysalis"), a company that manufactured circuit boards. Pet.App.38a, 80a-81a. To perform that task, Chrysalis obtained parts from various different suppliers, including petitioner Husky International Electronics. From 2003 through 2007, petitioner sold and delivered electronic device components to Chrysalis pursuant to a written contract. Pet.App.80a. Although respondent, as a director and partial owner, maintained financial control over Chrysalis, Pet.App.2a, 80a, he had no involvement in Chrysalis's negotiation of, entry into,

or execution of its contract with petitioner for the supply of electronic device components. Pet.App.83a; JA40. It is undisputed that respondent's first and only contact with petitioner was a brief telephone conversation that took place more than four years into the contractual relationship, after petitioner ceased shipping goods to Chrysalis. Pet.App.80a, 83a; JA39-40.

Over time, Chrysalis failed to pay for some of the goods delivered to it by petitioner, resulting in an unsecured debt of $163,999.38. Pet.App.80a-83a. While some or all of that debt was outstanding, respondent caused Chrysalis to transfer some of its funds to other entities that he owned or controlled. Pet.App.81a-82a. Respondent maintains that there was nothing nefarious about these transactions. He contends that the funds flowing out of Chrysalis were repayments of loans made to Chrysalis in the course of ordinary business by the other entities that he controlled. *See infra* pp.14-15.

In June 2007, petitioner filed a lawsuit in Texas state court against Chrysalis, respondent, and several of the entities controlled by respondent that had provided working capital loans to Chrysalis, alleging various state law claims relating to Chrysalis's unpaid debt. *See Husky Int'l Elecs., Inc. v. Chrysalis Mfg. Corp.*, No. 2007-39059 (280th Dist. Ct., Harris Cty., Tex.). In June 2008, while that state court case was still pending, Chrysalis filed for Chapter 7 bankruptcy. *See In re Chrysalis Mfg. Corp.*, No. 08-33793 (Bankr. S.D. Tex. June 12, 2008). The trustee of the Chrysalis bankruptcy estate did not attempt to use section 548(a) to avoid any of the transfers that

respondent caused Chrysalis to make during the two years before its bankruptcy filing. In February 2009, the trustee issued a no asset report. No assets were administered, and the case was closed that same month.

In May 2009, while its state court case was still pending, petitioner sued respondent in federal district court seeking to hold him personally liable for Chrysalis's breach of contract pursuant to section 21.223(b) of the Texas Business Organization Code, which permits piercing the corporate veil if a shareholder used a corporation to "perpetrate an actual fraud on" a creditor "primarily for the personal benefit of the" shareholder. *See* Compl. 4, *Husky Int'l Elecs., Inc. v. Ritz*, No. 4:09-cv-01532 (S.D. Tex. May 20, 2009) (Dkt. 1). According to petitioner, by causing Chrysalis to transfer assets to entities that he owned or controlled, respondent used Chrysalis to perpetrate an "actual fraud" against petitioner for his benefit. *Id.* at 4. Petitioner further alleged that respondent himself committed common-law fraud by making "representations to Husky" that "creat[ed] the impression that Husky would be paid for its goods while instead dissipating and transferring" Chrysalis's assets. *Id.* at 5. Petitioner alleged that respondent "knew the representations were false" or recklessly made and intended petitioner to rely on them. *Id.* Finally, petitioner also alleged claims for breach of fiduciary duty and recovery in quantum meruit. *Id.* at 5-6. Shortly after filing its federal suit, petitioner dismissed its state court case without prejudice.

In December 2009, before any aspect of the federal district court litigation was resolved, respondent filed a Chapter 7 bankruptcy petition. *See* Pet., *In re Ritz*, No. 09-39895 (Bankr. S.D. Tex. Dec. 31, 2009). An automatic stay of the district court litigation ensued. In March 2010, petitioner initiated this adversary proceeding in Bankruptcy Court, seeking to hold respondent responsible for paying Chrysalis's debt under Texas state law and bar him from discharging that obligation through his bankruptcy proceeding. Petitioner once again alleged that respondent is personally liable for Chrysalis's breach of contract pursuant to section 21.223(b) of the Texas Business Organization Code, and that he committed common-law fraud by making false representations to petitioner to induce it to sell the goods to Chrysalis. JA94. Petitioner claimed that the debt respondent purportedly owed petitioner for these state law claims should be excepted from discharge under the "actual fraud" prong of section 523(a)(2)(A), the section 523(a)(4) exception "for fraud or defalcation while acting in a fiduciary capacity," and the section 523(a)(6) exception "for willful or malicious injuries to the person or property of another." *See* JA96-97.

2. The Bankruptcy Court's Decision

The Bankruptcy Court held a bench trial, during which respondent adduced substantial evidence that the transfers were not an effort to drain a defunct Chrysalis of its assets in anticipation of a bankruptcy filing. On the contrary, the evidence showed that Chrysalis was a going concern from January 2006 until it ceased operations in May 2007. Throughout that timeframe, Chrysalis continued production at its

California manufacturing facility, paid its employees, purchased and paid for parts from its suppliers, and earned revenue. *See* Pet.App.57a, 61a. The evidence also showed that, during the same timeframe when respondent was authorizing the transfers of funds out of Chrysalis, several entities controlled by respondent were making transfers into Chrysalis on a continuing, short-term basis to fund its ongoing business operations. *See* Pet.App.50a, 55a, 62a; JA56-61, 67. Between January 2006 and May 2007, more than $2.8 million were transferred to Chrysalis, which exceeded Chrysalis's outbound transfers by more than $900,000. *See, e.g.*, JA56-60, 85-87; Pet.App.55a, 57a, 62a.

The Bankruptcy Court ultimately found that respondent caused Chrysalis to make transfers for "less than reasonably equivalent value." Pet.App.81. But it rejected each of petitioner's attempts to demonstrate that respondent's conduct gave rise to a debt excepted from discharge. Pet.App.79a. The court first held that respondent was not liable for Chrysalis's debt as a matter of state law because he did not use Chrysalis to "perpetrate an actual fraud" on petitioner within the meaning of section 21.223(b) of the Texas Business Organization Code. Pet.App.91a-92a. Reviewing state and federal court decisions interpreting section 21.223(b), the court concluded that "actual fraud" under that provision requires proof, *inter alia*, that the alleged fraudster made a material misrepresentation to the purported victim. Pet.App.92a.

Although petitioner had alleged in its complaint that respondent made material misrepresentations,

JA94, the Bankruptcy Court found that "[t]he record is wholly devoid of any such representation," Pet.App.92a. And with good reason, as petitioner's CEO openly conceded at trial that respondent never made *any* representations to his company—indeed, never even spoke with him until after petitioner had already made its last shipment of goods to Chrysalis. JA40. The court further concluded that even if respondent could be held liable for Chrysalis's debt pursuant to section 21.223(b), the ensuing debt to petitioner would not be excepted from discharge under section 523(a)(2)(A) of the Bankruptcy Code because the "actual fraud" prong of that provision likewise requires the debtor to have made a misrepresentation to the creditor. Pet.App.92a.

The court also rejected petitioner's remaining discharge exception claims. It held that any "fraud" respondent may have committed would not be excepted from discharge under section 523(a)(4) because respondent "owed no fiduciary duty to" petitioner. Pet.App.95a. And it found the record "wholly devoid of any proof that [respondent] willfully and maliciously injured Husky or Husky's property." Pet.App.96a. In reaching that conclusion, the court noted that "no exhibits were introduced, no testimony was adduced, and no briefing was done relating to §523(a)(6)"; instead, petitioner made only "a glancing reference to" that provision in its complaint. Pet.App.96a.

3. The District Court's Decision

Petitioner appealed, and the District Court affirmed. Although the court disagreed with the Bankruptcy Court's conclusion that a

misrepresentation is an element of "actual fraud" under section 21.223(b) of the Texas Code, it agreed with the Bankruptcy Court that a misrepresentation is an element of a claim under section 523(a)(2)(A) of the Bankruptcy Code. Pet.App.72a. Because it was undisputed at that point that respondent made no misrepresentation to petitioner, the court agreed that any debt respondent may owe to petitioner is not excepted from discharge under section 523(a)(2)(A). Pet.App.73a. The court also agreed with the Bankruptcy Court that petitioner failed to establish a debt excepted from discharge under section 523(a)(6), as "'[t]he record is wholly devoid of any proof" that respondent "willfully and maliciously" injured petitioner or its property. Pet.App.75a (quoting Pet.App.96a). Respondent did not appeal the Bankruptcy Court's ruling on its section 523(a)(4) claim.

4. The Court of Appeals' Decision

The Fifth Circuit unanimously affirmed. As to section 523(a)(2)(A), the court agreed with both courts below that "a representation is a necessary prerequisite for a showing of 'actual fraud' under Section 523(a)(2)(A)." Pet.App.17a. The court rejected the Seventh Circuit's contrary conclusion in *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000), as "in tension with" this Court's cases and common-law sources that "indicate that a representation is a necessary prerequisite" to a fraud claim. Pet.App.9a, 11a.[1] The

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[1] Having rejected petitioner's section 523(a)(2)(A) claim as a legal matter, the Court of Appeals did not address the question of respondent's liability under Texas law or petitioner's challenges to the lower courts' factual findings. Pet.App.6a-7a.

Fifth Circuit also affirmed the District Court's holding that petitioner failed to meet its "burden to prove" that respondent owed any debt for "willfully and maliciously" injuring petitioner or its property, finding "scant evidence in the record indicating either that Ritz made these transfers with the intent to harm Husky, or that harm to Husky was substantially certain due to Ritz's actions." Pet.App.18a.

SUMMARY OF ARGUMENT

Section 523(a)(2)(A) of the Bankruptcy Code is directed at a specific kind of debt: a "debt ... for money, property, services, or ... credit ... obtained by ... false pretenses, a false representation, or actual fraud." 11 U.S.C. §523(a)(2)(A). In other words, by its terms, the statute is directed only at a debt for money, property, services, or credit with which a debtor fraudulently induced a creditor to part. To state the obvious, a debtor cannot fraudulently induce a creditor to part with anything without employing some false or misleading word or deed to do the inducing. The statutory text reinforces that common sense point, speaking explicitly and repeatedly of conduct involving false or misleading statements or actions on which the creditor relied. Accordingly, as this Court recognized in *Field v. Mans*, section 523(a)(2)(A) applies only when a debtor has made some reliance-inducing misrepresentation.

Congress did not do away with that settled understanding by adding the term "actual fraud" to section 523(a)(2)(A). "Actual fraud" is not a term used to denote any particular form of conduct—let alone a form of conduct necessarily broader than fraudulent misrepresentation. Instead, as petitioner itself

reiterates repeatedly, that term is used to denote the *intent* with which the perpetrator must have acted. For example, a false representation may be actionable even if negligently or innocently made. But if a jurisdiction requires "actual fraud," then the representation must be knowingly false, and made with intent to induce the victim's reliance. That is exactly the sense in which Congress used the term "actual fraud" in section 523(a)(2)(A): to confirm that a misrepresentation must be *intended* to injure the creditor to give rise to a debt falling within the exception. The statute's "obtained by" requirement commands that conclusion, and the legislative history reinforces it, explaining that the 1978 revisions to the fraud exception were simply designed to confirm that the provision applies only to intentional, not "constructive," fraud.

To be sure, adding the phrase "*or* actual fraud" to the statute may not have been the most precise way of going about that task. But petitioner's reading of the statute produces far more serious textual concerns than an ill-advised use of the word "or." For instance, if "actual fraud" is a phrase of expansion, not limitation, then under petitioner's reading, it renders "false pretenses" and "false representation" utterly redundant. Moreover, if the term "actual fraud" covers conduct without regard to whether it induced *the creditor* to part with something (as petitioner insists it does), then the phrase "for money, property, services, or ... credit, to the extent obtained by" has no independent force either. Finally, if section 523(a)(2)(A) already covers the universe of debts having any connection to any conduct that conceivably might be described as "intended to defraud," then

there was no need for Congress to refer to "fraud" expressly in several other exceptions found in section 523(a). As between a reading that gives substantive meaning to every word in section 523(a)(2)(A) save perhaps "or," and one that deprives large swaths of statutory text of any force, the choice should be easy.

Petitioner's extended discussion of fraudulent conveyance law does not suggest otherwise. Whether fraudulent conveyances are a form of common-law fraud is largely irrelevant, as debts attributable to fraudulent conveyances do not fall within section 523(a)(2)(A) because they are not debts for anything "obtained by" the debtor from the creditor. Moreover, the cases on which petitioner relies only reinforce the conclusion that "actual fraud" is a term of intent, as they use that term to describe the scienter sometimes required to invoke a fraudulent conveyance law, not to render fraudulent conveyances a subset of some distinct category of conduct known as "actual fraud." For that very reason, commentators have noted that use of the term "fraud" in the fraudulent conveyance context is a misnomer, as fraudulent conveyances do not require "fraud" in the ordinary sense (or in the sense that section 523(a)(2)(A) requires)—*i.e.*, they do not require a reliance-inducing misrepresentation.

None of that means that a creditor injured by a fraudulent conveyance is without recourse. There are many provisions of the Bankruptcy Code that deal with fraudulent conveyances, whether explicitly or implicitly. Petitioner invoked one of those provisions—section 523(a)(6)'s exception for debts for willful and malicious injury to a creditor—in this case. Its efforts failed not because that exception was too

narrow to reach the conduct alleged, but because each court below concluded that petitioner failed to adduce any proof that respondent made the transfers in question with intent to harm petitioner. There is thus no need to accept petitioner's boundless conception of "actual fraud," or to do away with section 523(a)(2)'s "obtained by" requirement, to ensure that creditors have adequate remedies when debtors knowingly participate in transactions intended to hinder, delay, or defraud a creditor's ability to collect on a debt. Petitioner's inability to establish a debt excepted from discharge is a product not of some deficiency in the code, but of petitioner's simple failure to prove its case.

ARGUMENT

I. Section 523(a)(2)(A) Applies Only When The Debtor Made A Misrepresentation On Which The Creditor Relied.

Section 523(a)(2)(A) excepts from discharge any debt "for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by false pretenses, a false representation, or actual fraud." 11 U.S.C. §523(a)(2)(A). That provision is "not [an] innovation[] in [its] most recent codification," but rather "had obvious antecedents in" earlier bankruptcy laws. *Field*, 516 U.S. at 64. At times, the provision applied only to debts "created by ... fraud," 1867 Act §33, 14 Stat. at 533; at other times, it applied only to "liabilities for obtaining money or property by false pretenses or false representations," Chandler Act §17a(2), 52 Stat. at 851; *see also* 1898 Act §17a(2), 30 Stat at 550; 1903 Act §5, 32 Stat. at 798. But at all times, it has been directed at the same basic concept: a "debt [that] follows a transfer of value

or extension of credit induced by falsity or fraud." *Field*, 516 U.S. at 66; *see also, e.g.*, *Gleason*, 236 U.S. at 562.

To state the obvious, a transfer of value or extension of credit can be "induced by falsity or fraud" only if the debtor employs some false word or deed that induces the creditor to act. In other words, it can be induced only by a misrepresentation. To be sure, the concept of "misrepresentation" is a broad one, encompassing "not only words spoken or written but also any other conduct that amounts to an assertion not in accordance with the truth." Restatement (Second) of Torts §525 cmt. b (1977); *see also, e.g.*, William L. Prosser, *Handbook of the Law of Torts* §106, at 694 (4th ed. 1971) (a "representation ... usually consists, of course, of oral or written words; but it is not necessarily so limited"). But as a matter of common sense, the irreducible minimum of a claim that a debtor used fraud to induce a creditor to part with something is some false or misleading word or deed that does the inducing. Accordingly, this Court concluded in *Field* that, to establish a debt excepted from discharge under section 523(a)(2)(A), a creditor must prove the elements of the common-law tort of fraudulent misrepresentation—*i.e.*, a false or misleading act or deed on which the creditor justifiably relied to its detriment. *Field*, 516 U.S. at 70.

That is hardly a novel proposition. This Court has recognized repeatedly, both in the bankruptcy context and elsewhere, that "'[f]raud' typically requires a false statement or omission" on which the victim relied. *Bullock*, 133 S. Ct. at 1760; *see also, e.g.*, *Neder v.*

United States, 527 U.S. 1, 22 (1999) ("the well-settled meaning of 'fraud' require[s] a misrepresentation or concealment of material fact" (emphasis omitted)); *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 579 (1996) ("actionable fraud requires a material misrepresentation or omission" (emphasis omitted)). As reflected in myriad definitions over the years, that is what distinguishes fraud from other intentional torts: It injures the victim by inducing reliance. *See, e.g.*, Restatement (Second) of Torts §871 cmt. e (1979) ("[t]he actor's conduct is fraudulent if he intentionally causes another to act or refrain from acting by means of intentionally false or misleading conduct or by his intentional concealment of facts"); *Black's Law Dictionary* (10th ed. 2014) ("fraud: A knowing misrepresentation or knowing concealment of a material fact made to induce another to act to his or her detriment."); Restatement (Third) of Torts: Liability for Economic Harm Tentative Draft No. 2, §9 Reporters' note (2014) (defining "fraud" as "mak[ing] a material misrepresentation of fact, opinion, intention, or law, for the purpose of inducing another to act or refrain from acting").

Indeed, even the sources of the broader formulations of "fraud" on which petitioner relies reinforce the conclusion that common-law fraud requires a reliance-inducing misrepresentation. For example, petitioner parrots the Seventh Circuit's assertion in *McClellan* that "fraud is a 'generic term' that 'includes all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated.'" Pet'r.Br.23 (quoting *McClellan*, 217 F.3d at 893). But what the source on which Judge Posner relied for that claim says in full is that fraud is "a generic term,

which embraces all the multifarious means which human ingenuity can devise and which are resorted to by one individual to gain an advantage over another *by false suggestions or by the suppression of truth.*" *Stapleton v. Holt*, 250 P.2d 451, 453-54 (Okla. 1952) (emphasis added). And the Oklahoma Supreme Court affirmed the verdict on the defendant's fraud counterclaim in that breach of contract case only because the court found the evidence sufficient to support the defendant's allegations that the plaintiff made a "representation ... known by plaintiff to be false ... with the intention that it should be acted upon by defendant" to his detriment. *Id.* at 454.[2] Accordingly, petitioner's own cases reiterate that common-law fraud requires a misrepresentation on which the defendant relied to its detriment.

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[2] The same is true of other cases on which petitioner relies. For instance, although *Chien v. Chen*, 759 S.W.2d 484 (Tex. App. 1988), may have described fraud in broad terms, it found sufficient *evidence* of fraud because the defendant made a series of "false representation" to "induce[]" the victim to "sell the property" at "less than market value." *Id.* at 496; *see also Bullis*, 195 U.S. at 620-21 (finding "fraud" because "[t]he facts charged and found showed false and fraudulent representations as to the character of the property which was to be the security of those who should purchase the bonds, and resulted in depriving them wrongfully of valuable rights"). The other cases petitioner cites either deal with the use of "fraud" as an *intent* element, *see, e.g.*, *Wallace v. Wallace*, 291 S.E.2d 386, 388 (W. Va. 1982); *State v. Scofield*, 438 P.2d 776, 780-81 (Ariz. Ct. App. 1968), or with fraud while acting in fiduciary capacity, which is dealt with in a separate exception from discharge, *see, e.g.*, *Seeburg v. Norville*, 85 So. 505 (Ala. 1920); *Smith v. Harrison*, 2 Heisk. 230, 243 (Tenn. 1870).

The text of section 523(a)(2)(A) confirms that the exception applies only to that ordinary, common-law understanding of fraud. Most of the act's provisions refer explicitly to conduct that, by its terms, requires a misrepresentation. For instance, false pretenses has as its elements, *inter alia*, "a false representation ... which causes the victim ... to pass title to ... his property to the wrongdoer." Wayne R. LaFave, *Substantive Criminal Law* §19.7 (2d ed.). False representation has as its elements, *inter alia*, a "misrepresentation," "in reliance upon" which "the plaintiff has parted with money, or property of value." Prosser, §105, at 684; *see also id.* §107, at 699. And subparagraph (B) deals with debts for transfers induced by "a statement respecting the debtor's or an insider's financial condition." 11 U.S.C. §523(a)(2)(B). These provisions underscore that section 523(a)(2) is directed at a specific kind of debt: a debt that "follows a transfer of value or extension of credit induced by falsity or fraud," or "by a materially false and intentionally deceptive written statement of financial condition." *Field*, 516 U.S. at 66. And that kind of debt requires a misrepresentation.

To the extent there were any doubt on that score, section 523(a)(2)'s prefatory clause eliminates it. Section 523(a)(2) applies only to a debt "for money, property, services, or an extension, renewal, or refinancing of credit, *to the extent obtained by*" the conduct that its subparagraphs enumerate. 11 U.S.C. §523(a)(2)(A) (emphasis added). As this Court had little trouble recognizing in *Field*, "some degree of *reliance* is required to satisfy the element of causation inherent in the phrase 'obtained by.'" 516 U.S. at 66 (emphasis added). By confining section 523(a)(2)(A) to

debts "for" things "obtained by false pretenses, a false representation, or actual fraud," or a materially false written statement regarding financial condition, Congress made doubly clear that the exception applies only to conduct that induced the creditor to part with whatever it is that gave rise to the debt. Accordingly, read as a whole, the statutory text confirms that the only fraud subparagraph (A) reaches is fraud involving a misrepresentation on which the creditor relied to its detriment.

The leading bankruptcy treatise reflects the same understanding. Like the Oklahoma Supreme Court in *Stapleton*, Collier describes "fraud" in broad terms as "any deceit, artifice, trick, or design involving direct and active operation of the mind, used to circumvent and cheat another." 4 *Collier on Bankruptcy* ¶523.08[1][e] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2015) ("*Collier*"). But the treatise goes on to reiterate that, "[t]o sustain a prima facie case of fraud, a plaintiff under section 523(a)(2) must establish ... that the debtor made [a knowingly false] representation" on which "the plaintiff justifiably relied," and that "the plaintiff sustained a loss or damage as the proximate consequence of the representation having been." *Id.* Collier thus recognizes what the text, structure, and history of the statute make clear: Section 523(a)(2)(A) requires a misrepresentation that induced the creditor to part with its money, property, services, or credit.

II. The Term "Actual Fraud" Does Not Eliminate The Need To Prove A Reliance-Inducing Misrepresentation.

According to petitioner, section 523(a)(2)(A) is not confined to debts that involve a reliance-inducing representation. Nor is it confined to debts arising out of frauds through which the debtor induced the creditor to part with something of value. Instead, in petitioner's view, the exception applies to any debt traceable to any conduct that conceivably might be described as "intended to defraud." In petitioner's view, that is the only way to explain Congress' inclusion of the term "actual fraud" in section 523(a)(2)(A). *See* Pet'rBr.33. That reading suffers from any number of problems, not the least of which are its utter incompatibility with the statute's "obtained by" clause and the massive superfluity that it would produce. But it also rests on a fundamental misconception of the term "actual fraud," which is a term used to impose an *intent* requirement, not to define what *conduct* qualifies as "fraud."

A. "Actual Fraud" Is a Term Used to Describe Intent, Not a Particular Form of Conduct.

Petitioner's textual argument rests principally on the notion that "actual fraud" must cover a broader swath of conduct than misrepresentation in order to avoid rendering the term redundant of "false pretenses" and "false representation." *See* Pet'r.Br.37-38. But there is no need to strain to ensure that the term "actual fraud" causes section 523(a)(2)(A) to "cover something that the discharge bar did not cover before," Pet'r.Br.36, because Congress included that

term to *narrow* the scope of the exception, not to expand it. As petitioner itself argues repeatedly, at common law, the term "actual fraud" "has nothing to do with whether the fraud involves a misrepresentation." Pet'r.Br.15. Instead, "[t]he modifier 'actual' refers to the perpetrator's *mindset*—i.e., intentionally fraudulent conduct, as distinct from fraud implied in law." Pet'r.Br.9 (emphasis added). That is precisely the manner in which Congress used the term "actual fraud" in section 523(a)(2)(A): to confine the exception to intentional, not "implied" or "constructive," fraud.

The legislative history confirms as much. As the 1978 Act's sponsor explained, section 523(a)(2)(A) was not designed to "close[]" some unidentified "gap" in the long-standing fraud exception. Pet'r.Br.5.[3] Instead,

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[3] The sum total of petitioner's support for its "gap-filling" theory is a single floor statement from discussion of the 1903 amendments in which one Representative hypothesized that "there are many other frauds, of course, besides false pretenses and false representations," then observed that it "must ultimately be left to the courts" to decide whether the 1903 version of the code covered whatever else he was envisioning. 36 Cong. Rec. 1375 (Jan. 28, 1903) (statement of Rep. Mann). Petitioner identifies no further mention—whether in the 1978 legislative history or otherwise—of any concern that the pre-1978 term "false pretenses or false representation" was too narrow to cover the types of fraud Congress intended the exception to cover. Moreover, the Judiciary Committee report from the 1903 Act reveals that its amendments to section 17a were designed to close a gap, not create one. Whereas the 1898 Act version excepted only debts for "judgments in actions for fraud," 1898 Act §17a, "[t]he substitution of 'liabilities' for 'judgments in actions' ma[de] the clause broader" by ensuring that "claims created by fraud" would be excepted regardless of whether they were "reduced to judgment," H.R. Rep. No. 57-1698, at 6.

its was designed to "codify current case law, *e.g.*, *Neal v. Clark*, 95 U.S. 704 (1887), which interprets 'fraud' to mean actual or positive fraud rather than fraud implied in law." 124 Cong. Rec. H32,399 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards); *see also, e.g.*, 124 Cong. Rec. S33,998 (daily ed. Oct. 5, 1978) (statement of Sen. DeConcini) (same); S. Rep. No. 95-989, at 6 (1978) ("*As with current law*, certain debts, particularly those obtained by false pretenses, false representations, or actual fraud, are excepted from discharge." (emphasis added)). In other words, it was designed to confirm that a misrepresentation must be *intended* to induce the creditor's detrimental reliance in order to fall within the scope of section 523(a)(2)(A).

There is nothing particularly unusual about that usage. The term "actual fraud" is frequently employed to convey that conduct must be intentional to give rise to whatever legal consequences attach to it. *See, e.g.*, 37 Am. Jur. 2d *Fraud & Deceit* §8 (2d ed. Westlaw database updated Nov. 2015) ("Actual fraud usually involves dishonesty of purpose or intent to deceive and, as distinguished from constructive fraud, involves the element of deceit practiced upon the party defrauded." (footnote omitted)). "False representation" is a perfect example. While false representations may be actionable even when not made with knowledge or intent, only a false representation made with intent to injure qualifies as "actual fraud." *See, e.g.*, *Faulkenberry v. Kansas City S. Ry. Co.*, 602 P.2d 203, 206 & n.8 (Okla. 1979) (whereas "[a]ctual fraud is the intentional misrepresentation or concealment of a material fact[,] ... liability for constructive fraud may be based on a negligent or even innocent misrepresentation");

Proctor Trust Co. v. Upper Valley Press, Inc., 405 A.2d 1221, 1226 (Vt. 1979) ("'Actual fraud' is deceitful misrepresentation or concealment with evil intent, while 'constructive fraud' is wrongdoing without bad faith.").[4]

Indeed, petitioner itself uses "actual fraud" in the same manner, defining it only as "intentional fraud." *See, e.g.*, Pet'r.Br.19, 24, 32,34; *see also, e.g.*, U.S.Br.12. That is certainly a correct understanding of the term, but petitioner's utter inability to define "actual fraud" by reference to anything other than the level of intent it requires reveals the fundamental flaw in petitioner's argument: The term "actual fraud" simply does not say anything one way or another about the *kind* of intentional conduct that section 523(a)(2)(A) requires. That question is instead answered by the statute's other provisions, each of which plainly requires a misrepresentation, and the

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[4] *See also, e.g.*, *A.I. Credit Corp. v. Legion Ins. Co.*, 265 F.3d 630, 635 (7th Cir. 2001), *as amended on denial of reh'g* (Nov. 26, 2001) ("To prove 'actual' fraud under Indiana law, the defrauded party must establish that it was injured as a result of its justifiable reliance on a material misrepresentation ... made with knowledge of its falsity and in an effort to induce reliance."); *Richmond Metro. Auth. v. McDevitt St. Bovis, Inc.*, 507 S.E.2d 344, 346-47 (Va. 1998) (distinguishing a claim for "constructive fraud," which may be based on a false representation "made innocently or negligently" from a claim for "actual fraud," which may not); *Evans Indus. Coatings, Inc. v. Chancery Court of Union Cty.*, 870 S.W.2d 701, 703 (Ark. 1994) (defining "actual fraud" to require a misrepresentation with knowledge of falsity and intent to induce reliance); *Douglas v. Ogle*, 85 So. 243, 244 (Fla. 1920) ("'The distinguishing element of actual fraud ... is always untruth between the two parties to the transaction, so that actual fraud may be reduced to misrepresentation and concealment.'").

statute's "obtained by" clause, which plainly contemplates some word or act on which the creditor relied. *See supra* pp.25-26. Congress's inclusion of the term "actual fraud" is just the means by which it confirmed that section 523(a)(2)(A) also requires scienter.

According to petitioner, Congress had no need to impose an intent requirement on section 523(a)(2)(A) because "false pretenses" and "false representation" already required scienter. Pet'r.Br.37-38. But as explained, at common law, false representations that induced reliance could be actionable even if they were made without knowledge of the falsity. *See, e.g.*, 23 Am. Jur. *Fraud & Deceit* §127 (1939) ("one may be held liable for false representation .... even though the party making the statements does not know that they are false, but actually believes them to be true, and has no intention to deceive or defraud the other party"); Samuel Williston, *Liability for Honest Misrepresentation*, 24 Harv. L. Rev. 415, 427-28 (1911); *Derry v. Peek*, [1889] 14 App. Cas. 337. 374 (H.L.) (Lord Herschell) (explaining the difference between "fraud" and "false representation"). While some jurisdictions had rejected that view by 1978, certainly not all had. *See* Prosser, §107, at 705 ("A minority of the American courts have refused to accept *Derry v. Peek*, and have held that deceit will lie for negligent statements").

It was therefore perfectly reasonable for Congress to be concerned that courts might interpret the terms "false pretenses" and "false representation" as applying to innocent or negligent, rather than intentional, conduct. Indeed, this Court itself has

alluded (albeit in a case where the scope of those provisions was not at issue) to the possibility that the terms "false pretenses" and "false representation" in section 523(a)(2)(A) might require something less than fraudulent misrepresentation. *See Field*, 516 U.S. at 70 n.8. Surely "[i]t is no superfluity for Congress to clarify what" the text of the statute otherwise would have left "at best unclear." *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 543 n.7 (1994). This Court has "long acknowledged that a 'sufficient' explanation for the inclusion of a clause can be 'found in the desire to remove all doubts' about the meaning of the rest of the text." *Young v. United Parcel Serv., Inc.*, 135 S. Ct. 1338, 1363-64 (2015) (Scalia, J., dissenting) (quoting *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 420 (1819)). That explanation is more than sufficient here.

B. Petitioner's Reading of the Statute Exacerbates Any Superfluity Concerns.

Admittedly, Congress may not have gone about the task of imposing an intent requirement on section 523(a)(2)(A) with laser-like precision. But petitioner's alternative reading of the statute creates far worse problems than an imprudent use of the word "or." After all, if petitioner were correct that Congress included the term "actual fraud" to *broaden* the universe of "frauds" to which the exception applies to include any and all conduct undertaken with "intent to defraud," then the words "false pretenses" and "false representation" are superfluous under petitioner's reading, as petitioner insists that those

terms apply only to intentionally fraudulent conduct.[5] The "canon against surplusage" thus has "considerably less force in this case," as it "'assists only where a competing interpretation gives effect to every clause and word of a statute.'" *Marx v. Gen. Revenue Corp.*, 133 S. Ct. 1166, 1177 (2013). Here, the only competing interpretation petitioner has to offer exacerbates superfluity concerns.

And that is but the first of the superfluity problems that petitioner's reading would produce. In petitioner's view, by using the term "actual fraud," Congress extended section 523(a)(2)(A) to reach debts that not only are not the product of a misrepresentation on which the creditor relied, but are not for things that the debtor obtained *from the creditor*. Here, for instance, petitioner does not claim that it gave anything to *respondent*; instead, it seeks to hold respondent liable for the debt that *Chrysalis* owed petitioner for the electronic device components that Chrysalis received from petitioner.[6] Reading

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[5] Of course, those terms could still be given independent meaning by inferring from the inclusion of "actual fraud" that Congress intended them to apply *without regard* to the debtor's intent. But that would be a particularly perverse result when all signs point to the conclusion that Congress was trying to ensure that the statute would *not* reach "constructive" or "implied" fraud.

[6] In fact, petitioner's claim is even more attenuated than that, as petitioner does not even claim that *respondent* obtained any money from Chrysalis. Petitioner instead claims only that entities *controlled by* respondent obtained money from Chrysalis, and that the money *they* obtained from Chrysalis inured to respondent's benefit. The debt alleged here thus is (at least) twice removed from any money or property with which petitioner parted.

section 523(a)(2)(A) to reach such debts would be flatly inconsistent with the language confining the exception to debts "for money, property, services, or ... credit, to the extent *obtained by*" the conduct that it enumerates. 11 U.S.C. §523(a)(2) (emphasis added).

Attempting to resist that conclusion, petitioner claims it is enough to satisfy the statute's "obtained by" requirement that the debtor owes the creditor money because he used "actual fraud" to obtain something from *someone*, even if that someone was not the creditor. Pet'r.Br.39; *see also* U.S.Br.8, 17-18. But that strained reading of the text would deprive of all force Congress' decision to include the language "for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by" in subsection (a)(2) *and nowhere else*. Whereas the other provisions of section 523(a) are directed at debts "for" the various things that they enumerate (*e.g.*, debts "for ... embezzlement, or larceny," or "for willful and malicious injury," 11 U.S.C. §523(a)(4), (6)), subsection (a)(2) alone is confined to debts "for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by" the conduct it covers. If that language does not confine the exception to debts for money, property, services, or credit obtained *from the creditor*, then its inclusion is meaningless, as the same simple "for" that Congress used in all the other exceptions would have sufficed to "require[] causation" between the fraud and the debt. Pet'r.Br.42.

Moreover, petitioner's argument is undercut completely by the other provisions to which section 523(a)(2)'s "obtained by" requirement applies. In

addition to "actual fraud," subsection (A) also applies to "false pretenses" and "false representation." 11 U.S.C. §523(a)(2)(A). No one disputes that this conduct must be directed *at the creditor* to give rise to a debt excepted by section 523(a)(2)(A). *See Collier*, ¶523.08[1][d]. Subsection (B) reflects the same limitation: It requires a materially false writing about the debtor's financial condition "on which *the creditor* to whom the debtor is liable *for such* money, property, services, or credit reasonably *relied*." 11 U.S.C. §523(a)(2)(B)(iii) (emphasis added). And subsection (C) creates a presumption of nondischargeability when *the creditor* gave the debtor certain things within 90 or 70 days of obtaining bankruptcy relief. *Id.* §523(a)(2)(C). As these provisions underscore, section 523(a)(2) does not apply whenever the creditor can establish that the debtor directed a false word or deed at *someone*, or obtained something from *someone* through fraud. It applies only when the debtor used fraud to obtain something *from the creditor*.

"[T]he established interpretative canons of *noscitur a sociis* and *ejusdem generis*," *Wa. State Dep't of Social & Health Servs. v. Guardianship Estate of Keffeler*, 537 U.S. 371, 384 (2003), thus reinforce the conclusion that *all* of section 523(a)(2)—including its "actual fraud" language—applies only to debts for things obtained *from the creditor*. Subsection (C) provides a particularly strong case for "avoid[ing] ascribing to [actual fraud] a meaning so broad that it is inconsistent with its accompanying words," *Gustafson v. Alloyd Co.*, 513 U.S. 561, 575 (1995), as subsection (C) is a modification *to subsection (A)*. *See id.* §523(a)(2)(C)(i) ("for purposes of subparagraph (A)..."). Moreover, reading the exception as confined

to debts for things with which the debtor fraudulently induced the creditor to part is far more consistent with "the long-standing principle that 'exceptions to discharge should be confined to those plainly expressed.'" *Bullock*, 133 S. Ct. at 1760 (quoting *Kawaauhau*, 523 U.S. at 62); *see also, e.g.*, *Local Loan*, 292 U.S. at 244; *Gleason*, 236 U.S. at 562. As each of those canons confirms, as between an exceedingly expansive reading of an exception that renders large swaths of its text irrelevant, and a reading that simply calls into question Congress' use of the word "or," the choice is clear.

C. Petitioner's Reading Also Creates Superfluity Concerns as to Other Exceptions.

Precisely because petitioner refuses to recognize the evident purpose of the exception's "obtained by" language, its boundless conception of "actual fraud" would render several other exceptions delineated in section 523(a) superfluous as well. For example, in subsection (a)(4) of the statute, Congress excepted from discharge any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." 11 U.S.C. §523(a)(4). If petitioner were correct that section 523(a)(2) applies to all forms of "fraud" without regard to whether they induced the creditor to part with money, property, services, or credit, then the term "fraud" in section 523(a)(4) would be utterly redundant. Yet for more than a century, Congress has seen fit to have two *different* fraud exceptions, one relating to debts "created" or "obtained by" fraud, and another relating to debts for fraud committed in a fiduciary capacity *See, e.g.*, 1898 Act

§17a(4), 30 Stat. at 550-51. Congress retained that structure even after the Bankruptcy Commission initially encouraged it to drop "fraud" from subsection (a)(4) and include it only in subsection (a)(2). *See* H.R. Doc. No. 93-137, pt. II, at 139 n.10 (1973).

Petitioner tries to explain away that glaring redundancy problem by noting that subsection (a)(4) applies to "'fraud *or defalcation*'" by a fiduciary. Pet'r.Br.51 (emphasis added). That may explain why subsection (a)(4) *as a whole* is not superfluous, but it does nothing to explain why the provision specifically covers "fraud." Petitioner notes that subsection (a)(4) is *narrower* than its reading of subsection (a)(2)(A) because it applies only if the debtor was acting "in a fiduciary capacity." *Id.* But that just confirms that the redundancy petitioner's interpretation would produce is complete. And petitioner makes the puzzling suggestion that subsection (a)(4) is *broader* than subsection (a)(2)(A) because "some conduct may be fraudulent only if done in a fiduciary capacity." *Id.* But subsection (a)(4) applies only to *intentional* conduct, *see Bullock*, 133 S. Ct. at 1759, so anything that counts as fraud by a fiduciary would count as "actual fraud" under petitioner's "all intentional fraud" theory as well. Accordingly, under petitioner's reading, there is simply no way to reconcile Congress' inclusion of the term "actual fraud" in subsection (a)(2)(A) with its retention of the term "fraud" in subsection (a)(4).

And subsection (a)(4) is but one of multiple exceptions that refer explicitly to "fraud." Subsection (a)(19) excepts debts for violations of federal or state securities laws or "for common law fraud, deceit, or

manipulation in connection with the purchase or sale of any security." 11 U.S.C. §523(a)(19)(A). Subsection (a)(11) excepts debts "provided in any final judgment, unreviewable order, or consent order or decree entered in any court of the United States or of any State, issued by a Federal depository institutions regulatory agency, or contained in any settlement agreement entered into by the debtor, arising from any act of fraud or defalcation while acting in a fiduciary capacity committed with respect to any depository institution or insured credit union." *Id.* §523(a)(11). There is no apparent explanation why these exceptions are explicitly directed at specific types of "fraud" if petitioner is right that section 523(a)(2)(A) already covers the universe of debts that stem from any form of fraudulent conduct.

The explanation for this seeming overlap is self-evident: Section 523(a)(2)(A) is directed only at debts that "follow[] a transfer of value or extension of credit induced by falsity or fraud." *Field*, 516 U.S. at 66. If the debt arises out of some other form of intentional conduct, then the creditor's recourse is to some other exception—whether it be one of the other fraud exceptions, or the catchall exception "for willful and malicious injury by the debtor to another entity or to the property of another entity," 11 U.S.C. §523(a)(6). *See infra* pp.43-44. Recognizing that the term "actual fraud" does not eliminate the need for a reliance-inducing misrepresentation, but rather simply requires that inducement to be intentional, thus not only suffices to "give effect ... to every clause and word of" section 523(a)(2)(A), *Williams v. Taylor*, 529 U.S. 362, 404 (2000) (quotation marks omitted), but also

harmonizes that exception with the ones surrounding it.

That reading is also fully consistent with this Court's decisions in *Cohen v. de la Cruz*, 523 U.S. 213 (1998), and *Archer v. Warner*, 538 U.S. 314 (2003). In fact, each of those cases reinforces the conclusion that section 523(a)(2)(A) applies only when the debtor used a misrepresentation to induce the creditor to part with something. *Cohen* concerned whether section 523(a)(2)(A) excepted from discharge a judgment awarding treble damages to tenants whom the debtor had fraudulently induced to make rent payments. The question was whether a debt excepted under section 523(a)(2)(A) must be confined to "the value of the money, property, or services received by the debtor," or can encompass the full extent of the debtor's liability for its fraudulent conduct. 523 U.S. at 219. In concluding that the statute excepts debts to the full extent of the debtor's liability, the Court did not abandon the notion that the debtor must have received *something* from the creditor for the debt to come within the scope of section 523(a)(2)A). It instead found that condition *satisfied* because the debt was the product of rent payments that the debtor "obtained [from the creditors] by fraud." *Id.* And the Bankruptcy Court's decision below confirms that the fraud involved a reliance-inducing misrepresentation. *See In re Cohen*, 185 B.R. 180, 182 (Bankr. D.N.J. 1995) (finding "that ... the Debtor made a misrepresentation regarding the amount of rent" on which the tenants reasonably relied).

Petitioner's reliance on *Archer* is, if anything, more misplaced. The question in *Archer* was whether

section 523(a)(2)(A) excepts a "debt embodied in a settlement agreement that settled a creditor's earlier claim 'for money ... obtained by ... fraud'" (specifically, money that the debtors obtained by allegedly using fraud to induce the creditor to purchase their company for more than its value). 538 U.S. at 316. In concluding that it does, the Court reasoned that even though the debt had been reduced to a settlement agreement, the bankruptcy court was still obligated to determine whether the debt *underlying* that agreement was "a debt for *money obtained by fraud*." *Id.* at 319. If so, then the debt was excepted notwithstanding the "form" in which it was presented. *Id.* at 319, 321. Thus, far from departing from the rule that section 523(a)(2) requires a misrepresentation that induced the creditor to part with whatever it is that gave rise to the debt, *Archer* reiterates the obligation of courts to engage in "the fullest possible inquiry" to determine whether that is the case. *Id.* at 321.

Indeed, petitioner does not identify a single case in which this Court has accepted the notion that section 523(a)(2)(A) applies to debts that do not originate with a misrepresentation made to the creditor—let alone debts that do not involve *any* money, property, services, or credit obtained from the creditor. Instead, from *Field* all the way down the line, this Court has consistently recognized that section 523(a)(2)(A) applies only when the creditor establishes that the debtor made some misrepresentation that induced the creditor to part with whatever it was that gave rise to the debt. In short, "some degree of reliance is required to satisfy the element of causation inherent in the phrase

'obtained by.'" *Field*, 516 U.S. at 66. And a creditor can establish that reliance only by establishing a misrepresentation.

III. The Term "Actual Fraud" Does Not Import Fraudulent Conveyance Law Into Section 523(a)(2)(A) *Sub Silentio*.

Ultimately, even petitioner seems to recognize that defining "actual fraud" as "intentional fraud" does not advance its cause. Petitioner thus shifts to the argument that, whatever "actual fraud" may be, it must include participation in a conveyance intended to "hinder creditors' rights." Pet'r.Br.15; *see also* U.S.Br.21, 27 But the text of section 523(a)(2)(A) confirms that it does not apply to so-called "fraudulent conveyances," and there are ready explanations for why that is so. At any rate, the cases on which petitioner relies do not establish that fraudulent conveyances are a subset of "actual fraud." Instead, they demonstrate only that the term "actual fraud" is sometimes used to describe the *intent* necessary to avoid a conveyance that injures a creditor. In other words, they simply reinforce the conclusion that "actual fraud" is a term used to denote intent, not to define what conduct qualifies as fraud.

A. Neither the Making Nor the Receipt of Fraudulent Conveyance Is Covered by Section 523(a)(2)(A).

Petitioner spills much ink trying to establish the proposition that fraudulent conveyances are a form of fraud. But the question is academic, as fraudulent conveyances are plainly not a form of fraud that falls within the scope of section 523(a)(2)(A). As explained, section 523(a)(2)(A) is confined to debts that "follow[]

a transfer of value or extension of credit *induced by* falsity or fraud." *Field*, 516 U.S. at 66 (emphasis added). While a fraudulent conveyance certainly may injure a creditor, it does not do so by inducing the creditor to part with anything giving rise to a new debt. Instead, it does so by interfering with the creditor's ability to collect on a debt that *already exists*. Accordingly, whether it is intended to injure a creditor or not, a fraudulent conveyance simply does not give rise to the kind of debt that section 523(a)(2)(A) excepts from discharge.

Of course, that does not mean that a creditor injured by a fraudulent conveyance is without recourse. First, the Bankruptcy Code has long provided remedies against debtors who transfer their *own* assets in ways that injure their creditors. Such transfers are avoidable, and serve as grounds for denying a discharge of all debts if made with actual intent to injure a creditor. Under section 727(a)(2), a debtor may be denied a discharge if, within one year before filing for bankruptcy or at any time after, the debtor transferred any of his assets "with intent to hinder, delay, or defraud a creditor." 11 U.S.C. §727(a)(2). If a debtor transfers his assets in the *two* years before filing "with actual intent to hinder, delay, or defraud" a creditor, then the trustee may avoid the transfer. *Id.* §548(a)(1)(A). Finally, the trustee may also avoid such conveyances without regard to the debtor's intent if they were made for "less than a reasonably equivalent value" and at least one of four other conditions is satisfied. *Id.* §548(a)(1)(B). Accordingly, there is no need to have an *exception* for debts arising out of fraudulent transfers of the debtor's

own assets because the code separately deals with that conduct expressly.[7]

That leaves the question of the kind of conduct alleged (albeit not proven) in this case—namely, debts attributable to a debtor's participation in a transfer by some *other* debtor, in an alleged attempt to injure *that* debtor's creditors. In other words, it leaves the question of debtors who, before filing for bankruptcy, were the knowing recipient of someone else's fraudulent transfer. But there is no need to try to cram knowing *receipt* of a fraudulent transfer into section 523(a)(2)(A) either because the code already has a provision broad enough to encompass that conduct as well. Indeed, for more than a century, the code has contained an exception for intentional wrongdoing that injures a creditor, but not by inducing it to part with money, property, services, or credit. It excepts from discharge debts "for willful and malicious injury by the debtor to another entity or to the property of another entity." 11 U.S.C. §523(a)(6).

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[7] Petitioner's *amici* suggest that these remedies are insufficient because they apply only to transactions made within one or two years of filing for bankruptcy (or, for purposes of section 548(a), when authorized by state law). *See, e.g.*, U.S.Br.20, 27-28 n.7; Nat'l Ass'n of Bankr. Trustees *Amicus* Br.11-13. But those temporal limits are not some inadvertent defect in the code; they are the manifestation of Congress' considered judgment as to when a transaction is most likely to be animated by intent to hinder, delay, or defraud a creditor. Accordingly, it hardly helps petitioner's cause to claim, as its *amici* do, that reading section 523(a)(2)(A) broadly would allow creditors to except from discharge debts attributable to transactions arising *outside* the two-year timeframe Congress selected.

Unlike section 523(a)(2), that provision is not confined to debts "for money, property, services, or ... credit ... obtained by" such conduct; it instead applies to *any* debt "for willful and malicious injury." *Id.* Section 523(a)(6) thus supplies a "far more direct avenue for dealing with a" claim that a debtor should be held responsible for *someone else*'s debt because it knowingly accepted a transfer designed to hinder *someone else*'s creditors. *McClellan*, 217 F.3d at 896 (Ripple, J., concurring); *see also, e.g.*, *In re Bammer*, 131 F.3d 788, 790-93 (9th Cir. 1997); *In re Jennings*, 670 F.3d 1329, 1334 (11th Cir. 2012). The level of intent required under section 523(a)(6) poses no obstacle to invoking that provision in appropriate circumstances, as making or receiving a transfer with intent to delay, hinder, or defraud a creditor has long been considered "malicious" conduct. *See, e.g.*, Orlando F Bump, *Fraudulent Conveyances: A Treatise Upon Conveyances Made by Debtors to Defraud Creditors* 22 (3d ed. 1882) ("Every contrivance ... to the intent to delay, hinder or defraud creditors is malicious.").[8]

Petitioner's appeals to "the Bankruptcy Code's 'basic policy' of 'affording relief only to an honest but unfortunate debtor,'" Pet'r.Br.44 (quoting *Cohen*, 523 U.S. at 217), are therefore entirely misplaced. The question here is not whether Congress was concerned

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[8] *See also, e.g.*, *Hafner v. Irwin*, 23 N.C. 490, 498 (1841) ("[e]very contrivance to the intent to hinder creditors—directed to that end—is 'malicious'"); *Baldwin v. Peet, Sims & Co.*, 22 Tex. 708, 715 (1859) ("[a] failing debtor has not a right to maliciously, covinously, etc., execute a deed with intent to hinder, delay, or defraud his creditors").

with debts attributable to conduct undertaken with deliberate intent to injure a creditor. As several provisions of the code reflect, Congress undoubtedly was. The question here is whether section 523(a)(2) is the home for every debt in any sense attributable to any conduct that conceivably might be described as "fraudulent." It is not. Section 523(a) has many exceptions, of which subsection (a)(2) is but one. That exception should not be expanded at the expense of another (or, more aptly, several others) just because the debtor is accused of having acted "dishonestly."

That does not mean that the question of *which* exception covers a particular type of debt is without consequence. It matters a great deal in the Chapter 13 context, where section 523(a)(2) applies but section 523(a)(6) does not. That is not an oversight. It is a reflection of Congress' decision to make "[a] discharge under Chapter 13 ... 'broader than the discharge received in any other chapter,'" *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 268 (2010), in hopes of incentivizing debtors to see their Chapter 13 plans through to completion, *see, e.g.*, H.R. Rep. No. 95-595, at 129 (1977) ("The fact that a discharge would not be available in a [Chapter 7] case should furnish a greater incentive for the debtor to perform under the [Chapter 13] plan."). Allowing creditors to smuggle section 523(a)(6) claims into section 523(a)(2)(A) thus would undermine Congress' efforts to encourage debtors to use a process under which more creditors are actually likely to be paid.

In sum, Congress made a conscious decision to except different kinds of debts in different places, and that decision must be respected. Expanding the scope

of an exception based on vague conceptions of "basic policy" not only can have unintended consequences, but also is inconsistent with elementary principles of statutory construction. *See, e.g.*, *Bd. of Governors of Fed. Reserve Sys. v. Dimension Fin. Corp.*, 474 U.S. 361, 373-74 (1986) ("[a]pplication of 'broad purposes' of legislation at the expense of specific provisions ignores the complexity of the problems Congress is called upon to address"). That is precisely why this Court has repeatedly reaffirmed "the long-standing principle that 'exceptions to discharge should be confined to those plainly expressed.'" *Bullock*, 133 S. Ct. at 1760 (quoting *Kawaauhau*, 523 U.S. at 62); *see also, e.g.*, *Local Loan*, 292 U.S. at 244; *Gleason*, 236 U.S. at 562.

B. Fraudulent Conveyance Cases Only Underscore that "Actual Fraud" Is a Term of Intent.

At any rate, petitioner's extended detour into the history of fraudulent conveyance law is not only irrelevant, but counterproductive. The cases petitioner invokes reinforce the conclusion that "actual fraud" is a term used to differentiate between intentional and negligent or innocent conduct, not a catchall used to denote every form of conduct that conceivably might be described as fraud. Indeed, *Neal v. Clark*, the principal fraudulent conveyance case on which petitioner relies, does not hold that fraudulent conveyance is a subset of "actual fraud." Instead, it simply uses the term "actual fraud" to distinguish conveyances "involving moral turpitude or intentional wrong" from those involving "implied fraud, or fraud

in law, which may exist without the imputation of bad faith or immorality." *Neal*, 95 U.S. at 709.

Petitioner makes much of the fact that *Neal* drew that distinction in a case involving a claim that a debt attributable to the receipt of a purportedly fraudulent conveyance was excepted from discharge under the 1867 Act's exception for debts "created by ... fraud." From there, petitioner would have the Court infer that Congress' inclusion of the term "actual fraud" was intended not to incorporate *Neal*'s *holding*, but as an indirect way of signaling Congress' desire to expand section 523(a)(2)(A) to reach any debt analogous to the debt alleged in *Neal*. *See* Pet'r.Br.21-22. That argument might fare better if *Neal* had held, as petitioner suggests, that the recipient *would* have owed a debt excepted from discharge had he accepted the conveyance with intent to injure the creditor. But the only thing the Court held in *Neal* was that "the debt or claim asserted against Neal was *not* 'created by the fraud ... of the bankrupt'" because it did not involve "positive fraud, or fraud in fact, involving moral turpitude or intentional wrong." 95 U.S. at 709 (emphasis added). The Court said nothing one way or another about whether there *would* have been a debt "created by the fraud ... of the bankrupt"—let alone a debt "for money, property, services, or ... credit ... obtained by ... actual fraud," 11 U.S.C. §523(a)(2)(A)—had Neal acted with scienter.

Neal thus establishes nothing more than that "actual fraud" means "positive fraud." *Neal*, 95 U.S. at 709. And the legislative history confirms that the only thing Congress intended section 523(a)(2)(A) to "codify" was *Neal*'s holding "interpret[ing] 'fraud' to

mean actual or positive fraud rather than fraud implied in law." 124 Cong. Rec. H32,399 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards); *see also, e.g.*, 124 Cong. Rec. S33,998 (daily ed. Oct. 5, 1978) (statement of Sen. DeConcini) (same). That is hardly surprising, as what petitioner hypothesizes would have been an exceedingly roundabout means of trying to ensure that debts like the one alleged (but not proven) in *Neal* were excepted from discharge.

Indeed, it is difficult to conceive of a more convoluted way to establish an exception for debts attributable to the knowing receipt of a fraudulent conveyance than dropping a phrase used to describe the *intent* element of some fraudulent conveyance laws into the middle of the lone exception confined to debts "for money, property, services, or ... credit ... obtained by" particular *conduct*, and hoping that savvy readers would catch the sly cross-reference to the allegations (not the holding) of *Neal*. The far more simplistic way to achieve that end would have been to add an exception for debts "for fraudulent conveyance." Moreover, if fraudulent conveyances were really Congress' concern, it certainly would have made more sense to employ the phrase "hinder, delay, or defraud a creditor"—the phrase that Congress has used in the fraudulent conveyance context for nearly 150 years, and borrowed from laws dating back even further than that. *See* 1867 Act §35, 14 Stat. at 534; *BFP*, 511 U.S. at 540. In all events, Congress had no need to do any of that in 1978 because section 523(a)(6) was already broad enough to cover debts attributable to the knowing receipt of an intentionally fraudulent conveyance.

The other fraudulent conveyance cases on which petitioner relies are no more helpful to its position than *Neal*. Each case likewise uses the term "actual fraud" to describe an intent element, not to describe the broader category of tort law to which fraudulent conveyance belongs. For instance, *Coder v. Arts*, 213 U.S. 223 (1909), concerned the precursor to section 548 in the 1898 Act, which allowed the trustee to avoid any transfer made by a debtor within four months of filing for bankruptcy "with the intent and purpose on his part to hinder, delay, or defraud his creditors." 1898 Act §67e, 30 Stat. at 564. The question before the Court was whether that intent element had to be proven, or whether a debtor could be "presumed to have intended such consequences" whenever a transfer was made within four months of the petition. 213 U.S. at 241. The Court used the term "actual fraud" only in the context of explaining "[w]hat is meant" by the phrase "intent on the bankrupt's part to hinder, delay, or defraud creditors," concluding that the intent required by that phrase is synonymous with the intent required by "actual fraud." *Id.* at 242.

Bean v. Smith, 2 F. Cas. 1143 (D.R.I. 1821) (Story, J.), used the phrase "actual fraud" to the same effect. That case concerned an effort to avoid transactions under Rhode Island's fraudulent conveyance statute. In determining whether the transactions should be "'utterly void'" as against injured creditors, but the purchaser might still be given some equitable relief, Justice Story (riding circuit) concluded that the answer turned on whether the conveyance was received with "inten[t] to injure" the debtors' creditors, or was just "obtained under suspicious or inequitable circumstances." *Id.* at 1159. And he described that as

commensurate with the "distinction between actual and presumed fraud." *Id.* The other bankruptcy cases on which petitioner relies likewise use the phrase "actual fraud" in the context of identifying the proof necessary to establish "intent to hinder or delay" a creditor when trying to avoid a transfer, not of determining whether a debt was "created" or "obtained" by "fraud." *See* Pet'r.Br.28-31 (citing cases holding that intent required by "proof of intent to hinder or delay" is equivalent to the intent required by "actual fraud").

Just as in other contexts, then, in the fraudulent conveyance context the term "actual fraud" speaks to the intent with which conduct must be undertaken, not to what kind of conduct qualifies as "fraud." The Uniform Law Commission recently emphasized precisely that point in renaming the erstwhile "Uniform Fraudulent Transfer Act" the "Uniform Voidable Transactions Act." *See* Unif. Voidable Transactions Act ("UVTA") §15 & cmt. 1 (Unif. Law Comm'n 2014). As the Commission explained, the frequent use of the terms "actual fraud" and "constructive fraud" in this area of law can be "highly misleading" because "a transaction need not bear any resemblance to common-law fraud" to be voidable. *Id.* §4, cmt. 8; *see also id.* §15, cmt. 1 ("the word 'Fraudulent' in the original title, though sanctioned by historical usage, was a misleading description of the Act as it was originally written" because "[f]raud is not, and never has been, a necessary element of a claim for relief under the Act").

That is so even under the provision of the UVTA that requires intent to hinder, delay, or defraud

creditors. As the Commission explained, "'[h]inder, delay, or defraud' is best considered to be a single term of art describing a transaction that unacceptably contravenes norms of creditors' rights," not a transaction that has "a necessary element" some sort of "fraud." *Id.* §4, cmt. 8. The Commission thus not only found the term "constructive fraud" "oxymoronic and confusing," but also found "the shorthand tag 'actual fraud' .... misleading" in this context because the phrase intent to "hinder, delay, or defraud" "does not in fact require proof of fraudulent intent." *Id.* §14, cmt. 1. The Commission therefore excised the term "fraud" from the UVTA entirely, and concluded that doing so did not alter the scope of the Act one bit.

Section 871 of the Restatement (Second) of Torts also underscores the distinction between an *avoidable* transaction and a *fraudulent* one. In its discussion of the tort of "intentional harm to a property interest," the Restatement provides as an example of that tort a claim that "title to land has been obtained by fraud." Restatement (Second) of Torts §871 cmt. a. Section 871 goes on to explain that "[t]he actor's conduct is fraudulent if he intentionally causes another to act or refrain from acting by means of intentionally false or misleading conduct or by his intentional concealment of facts or by his intentional failure to disclose a fact that he has a duty to reveal to the other." *Id.* §871 cmt. e. And section 871 provides as an example of an intentional harm to a property interest attributable to "fraud" a situation in which "one misrepresents to another the financial ability of himself or of a third person, as a result of which the other transfers property." *Id.* Section 871 thus reinforces the conclusion that, even if the term "fraud" may be used

in both contexts, there is a fundamental difference between a conveyance intended to "hinder, delay, or defraud," and a conveyance attributable to "fraud."[9]

As both section 871 and the recent revisions to the UVTA underscore, regardless of whether fraudulent conveyances qualify as a form of fraud in the abstract, they are simply not the same thing as common-law fraud. That tort instead has as its elements, *inter alia*, a misrepresentation that injured the victim by inducing its reliance. And that tort is the only one that falls within the scope of section 523(a)(2)(A)'s exception "for money, property, services, or an extension, renewal, or refinancing of credit ... obtained by ... false pretenses, a false representation, or actual fraud." 11 U.S.C. §523(a)(2)(A). That is not to say that a creditor injured by the knowing receipt of a conveyance intended to interfere with its ability to collect on a debt is without recourse. Its recourse just is not to section 523(a)(2)(A).

C. Petitioner's Failure to Demonstrate a Debt Excepted from Discharge Is the Product of an Evidentiary Failing.

The notion that debts attributable to knowing receipt of an intentionally fraudulent conveyance belong in section 523(a)(6) should come as no surprise

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[9] The First Circuit made the perplexing argument that section 871 of the Restatement somehow supports the interpretation of section 523(a)(2)(A) that petitioner advances here. *See In re Lawson*, 791 F.3d 214, 219 (1st Cir. 2015). In fact, it does just the opposite. By treating a property transaction as the product of "fraud" only when it involves a misrepresentation, section 871 confirms that transactions are not necessarily "fraudulent" in the true sense merely because they intentionally injure a creditor.

to petitioner. Petitioner invoked section 523(a)(6) in this very case. Its efforts to do so did not fail because the lower courts concluded that the conduct petitioner alleged could not give rise, as a matter of law, to a debt excepted from discharge under section 523(a)(6). They failed because the courts below found that even if respondent caused Chrysalis to make transfers for less than reasonably equivalent value (a finding that respondent challenged in every court below, but the Fifth Circuit had no need to address), there was "scant evidence in the record that Ritz made the[] transfers *with the intent to harm Husky*." Pet.App.18a (emphasis added); *see also* Pet.App.75a-76a (affirming Bankruptcy Court's finding that the record was "'wholly devoid of any proof that [respondent] willfully and maliciously injured Husky or Husky's property'" (quoting Pet.App.96a)). Petitioner's inability to establish the existence of a debt excepted from discharge thus is a product not of some deficiency in the Bankruptcy Code, but of petitioner's failure to prove that respondent actually did it any intentional harm.

That not only explains why petitioner's section 523(a)(6) argument failed. It also confirms that the Court should affirm no matter how it resolves the question presented, as petitioner failed to prove that any wrongdoing on respondent's part was intended to "hinder, delay, or defraud" petitioner. To be sure, the courts below made their intent findings in the context of rejecting petitioner's section 523(a)(6) claim rather than its section 523(a)(2) claim. But the courts did not employ some unusually stringent intent standard in doing so. They instead asked only whether respondent acted with either "'objective substantial certainty of

harm or a subjective motive to cause harm.'" Pet.App.17a (quoting *Miller v. J.D. Abrams, Inc.*, 156 F.3d 598, 606 (5th Cir. 1998)). Surely petitioner cannot mean to suggest that anything less would suffice to establish "actual fraud." *Cf. Kawaauhau*, 523 U.S. at 61-62 (noting that the phrase "willful and malicious" "triggers in the lawyer's mind the category 'intentional torts,' as distinguished from negligent or reckless torts").[10]

Indeed, petitioner does not attempt to identify any daylight between the standard that the courts below applied to its section 523(a)(6) claim and the intent required to demonstrate "actual fraud."[11] Instead, petitioner merely appears to fight the lower courts' factual findings on its section 523(a)(6) claim,

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[10] The government alludes to a circuit split on whether section 523(a)(6) requires *subjective* intent to injure, or whether "objective substantial certainty of harm" will suffice. *See* U.S.Br.28-29 n.8. To the extent that circuit split exists, *but see Jendusa-Nicolai v. Larsen*, 677 F.3d 320, 324 (7th Cir. 2012), it has no bearing on whether section 523(a)(6) covers debts attributable to "actual fraud," as it suggests only that the "willful and malicious" standard may be more *lenient* than the standard for proving "actual fraud." And that potential split certainly does not help petitioner, as the courts below applied the (arguably) more lenient "objective substantial certainty" in rejecting petitioner's section 523(a)(6) claim. *See* Pet.App.17a.

[11] In its certiorari-stage reply brief, petitioner suggested that "actual fraud" requires only intent to benefit oneself, not intent to do harm to another. *See* Cert.Reply.4. Petitioner does not repeat that contention in its opening brief—and with good reason, as it is flatly inconsistent with the reality that fraudulent conveyance cases use "actual fraud" as a shorthand for "intent to hinder, delay, or defraud a creditor." *See supra* Part III.B. By its terms, that standard demands a showing of intent to injure the creditor, not just intent to benefit oneself.

suggesting that they are irreconcilable with the Bankruptcy Court's finding that respondent "drained substantial funds out of Chrysalis[]," Pet.App.98a. *See* Pet'r.Br.7-8 & n.3. But even setting aside the rule that this Court does not ordinarily review factual findings accepted by two courts—let alone three—*see, e.g.*, *United States v. Ceccolini*, 435 U.S. 268, 273 (1978), petitioner made the exact same argument below, to no avail. As the Fifth Circuit explained in rejecting it, *see* Pet.App.18a, even assuming petitioner did cause Chrysalis to make transfers for less than reasonably equivalent value, that alone would not suffice to prove that he did so *with intent to injure respondent*. Instead, petitioner needed to put on some actual evidence to substantiate its claim of intent to cause injury, which petitioner utterly failed to do. *See* Pet.App.18a. Accordingly, at most, petitioner proved only a form of "constructive fraud," which even petitioner concedes is insufficient to qualify as "actual fraud" under section 523(a)(2)(A).

But ultimately, the intent question is beside the point because petitioner's section 523(a)(2)(A) claim fails for a more basic reason: Respondent neither made any misrepresentation to petitioner nor induced petitioner to part with anything. Accordingly, even if petitioner could conjure some evidence to support its effort to impute *Chrysalis*'s debt to respondent, petitioner still could not establish any debt "for money, property, services, or an extension, renewal, or refinancing of credit ... obtained by ... false pretenses, a false representation, or actual fraud." 11 U.S.C. §523(a)(2)(A).

CONCLUSION

The Court should affirm the decision below

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IN THE

Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC.

Petitioner,

v.

DANIEL LEE RITZ. JR.,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

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INTRODUCTION

When Congress added "actual fraud" as a ground for barring discharge, it used that term according to its settled meaning. Actual fraud refers to fraudulent acts that are committed intentionally Centuries-old historical usage establishes that actual fraud includes a transferee's receipt of property through a conveyance that he knows is intended to defraud creditors. Congress codified that understanding in 1978. Thus, when a debtor knowingly obtains property through a fraudulent transfer, he commits actual fraud himself, and § 523(a)(2)(A) bars discharge of the resulting debt.

Respondent recognizes the need to give substantive meaning to Congress's 1978 amendment. To do so, he advances the novel theory—not adopted even by the Fifth Circuit below—that Congress added the words "or actual fraud" to narrow the preceding terms "false pretenses" and "false representation." He contends that "actual fraud" is an adjective referring to *mens rea*, and that "or" introduces a modifier to whatever comes before it. Respondent thus reads "false pretenses, a false representation, or actual fraud" to mean "intentional false pretenses or an intentional false representation."

That is a crime against grammar. The disjunctive "or" expands upon the noun phrases that precede it; it does not limit or modify them. Moreover, "actual fraud" is itself a noun phrase, not an adjective. It describes both conduct (fraud) and how it is carried out (intentionally). Thus, consistent with basic grammar and common-law usage, Congress added "or actual fraud" to expand the fraud discharge bar and

to ensure that it covers all forms of intentional fraud, not just those involving misrepresentations.

ARGUMENT

I. CONGRESS'S 1978 AMENDMENT ADDED "ACTUAL FRAUD" AS A GROUND FOR BARRING DISCHARGE

Congress amended § 523(a)(2)(A) in 1978 to add "actual fraud" as an additional ground for discharge. Respondent nevertheless insists that the words "or actual fraud" *narrowed* the discharge bar. But no one would use "or" followed by a noun phrase to modify the two preceding noun phrases—that is, to describe the manner in which a debtor commits false pretenses or makes a false representation.

A. Congress Used The Word "Or" To Expand The Scope Of § 523(a)(2)(A)

According to Respondent, Congress used "or" to limit the terms before it. That usage of "or" is not just "ill-advised." Resp.Br.19. It is illiterate.

1. This Court has recognized repeatedly that "or" is a disjunctive that typically connects words with "separate meanings" to *expand* a statute's scope; it is not used to "modify" one word with another. *Reiter v. Sonotone Corp.*, 442 U.S. 330, 339 (1979).

Reiter construed a statute allowing private antitrust plaintiffs to sue for injuries to "business or property." *Id.* at 335. Consumers alleged that they paid higher prices as a result of manufacturers' anti-competitive conduct. *Id.* Asserting that "business" modified "property," the manufacturers claimed that "business or property" meant "'business activity or property related to one's business,'" such that only

commercial injuries were actionable. *Id.* at 338. They further argued that, if "property" were not limited to business activity, "business" would become superfluous because *any* harm to business is pecuniary and, thus, an injury to property. *Id.*

Reiter rejected that "strained construction." *Id.* "Congress's use of the word 'or,'" the Court explained, "makes plain that 'business' was not intended to modify 'property,' nor was 'property' intended to modify 'business.'" *Id.* at 339. *Reiter* accordingly refused to "ignore the disjunctive 'or,'" "rob the term 'property' of its independent and ordinary significance," and "convert the noun 'business' into an adjective." *Id.* at 338-39. Other decisions reflect similar reasoning. *See Loughrin v. United States*, 134 S. Ct. 2384, 2390 (2014) (rejecting statutory construction that "effectively reads 'or' to mean 'including'"); *Ali v. Fed. Bur. of Prisons*, 552 U.S. 214, 224-25 (2008) (last item in disjunctive phrase not modified by preceding items); *Garcia v. United States*, 469 U.S. 70, 73 (1984) (Congress's "use of a disjunctive" means that each term must be given its "ordinary" meaning).

2. Likewise, § 523(a)(2)(A) uses the word "or" according to its ordinary meaning, as a disjunctive. Congress's use of "or" "makes plain that ['actual fraud'] was not intended to modify ['false pretenses' and 'false representation']." *Reiter*, 442 U.S. at 339. And each term that "or" connects—false pretenses, false representation, actual fraud—has its own settled meaning that must be given effect. *See* Pet.Br.36-38.

Indeed, the House and Senate reports explain that Congress "added" the words "actual fraud" as a *new* "ground[] for exception from discharge." S. Rep. No. 95-989, at 78 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5784, 5864; H.R. Rep. No. 95-595, at 384 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6320. This closed a gap in prior law: Courts and members of Congress recognized that, before the 1978 addition of "actual fraud," § 523(a)(2)(A)'s predecessor did not cover debts arising from the "many *other* frauds ... besides false pretenses and false representations."[1] 36 Cong. Rec. H1375 (daily ed. Jan. 28, 1903) (statement of Rep. Mann) (emphasis added); *see, e.g.*, *Zimmern v. Blount*, 238 F. 740, 744-45 (5th Cir. 1917) (observing that "[a] fraud may be committed in ways other than by the making of false representations," but that "false pretenses" and "false representations" were "the only kind[s] of fraud" covered by § 523(a)(2)(A)'s predecessor); *Drake v. Vernon*, 128 N.W. 317, 319 (S.D. 1910) (noting that § 523(a)(2)(A)'s predecessor reached "[o]nly" those frauds "connected with the obtaining of property by 'false pretenses or false representations'"). By adding the words "or actual fraud," Congress closed this gap and ensured that all debts arising from intentionally

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[1] Respondent incorrectly claims that "the 1978 Act's sponsor explained ... [that] section 523(a)(2)(A) was not designed to 'close' some unidentified 'gap' in the long-standing fraud exception." Resp.Br.28. No member of Congress said any such thing, and the House and Senate Reports refute it. *See* S. Rep. No. 95-989 at 78; H.R. Rep. No. 95-595 at 384; *see also* Resp.Br.28 n.3 (incorrectly attributing statement by Rep. Jenkins to Rep. Mann).

fraudulent conduct would be nondischargeable. *See* Pet.Br.36-38.

B. Actual Fraud Refers To Conduct And The Manner In Which It Is Committed—Not Merely A Mental State

Not only is "or" a term of expansion, but "actual fraud" is also not an adjective. Like "false pretenses" and "false representation," it is a noun phrase: The noun "fraud" refers to the perpetrator's acts (including participation in a fraudulent conveyance); the adjective "actual" refers to his mindset (i.e., whether the fraud was intentional).

1. For nearly 500 years, courts have used "actual fraud" to refer to intentionally fraudulent conduct, including a party's knowing participation in a conveyance intended to defraud creditors. *See* Pet.Br.20-32. Congress used "actual fraud" according to this settled meaning. Indeed, as Respondent recognizes, Congress derived the words "actual fraud" from *Neal v. Clark*, 95 U.S. 704 (1877). Resp.Br.29. And *Neal* used the phrase to describe a particular type of conduct: Knowing participation in a deliberately fraudulent conveyance—i.e., an act (participation in a conveyance) perpetrated with intent (to cheat creditors). *See* 95 U.S. at 707

Section 523(a)(2)(A)'s grammatical structure confirms that Congress used "actual fraud" in this manner, not as an adjective. Section 523(a)(2)(A) sets forth a series of noun phrases that refer to particular forms of "conduct." Resp.Br.25. The fundamental rule of parallelism dictates that Congress used "actual fraud" to "serve the same grammatical function in the sentence." THE CHICAGO MANUAL OF

STYLE § 5.212, at 259 (16th ed. 2010). Moreover, other sections of the Code confirm that Congress knew how to specify a particular *mens rea* when it wanted to. *See, e.g.*, 11 U.S.C. § 522(q)(1)(B)(iv) (debts arising from "*intentional* tort[s]" and "*willful* or *reckless* misconduct" (emphasis added)); *id.* § 526(c)(2)(B) (addressing "*intentional* or *negligent* failure to file [documents]" (emphasis added)). If Congress had wanted to add a *mens rea* to § 523(a)(2)(A), it would have said "intentional false pretenses or an intentional false representation." By instead referring to "actual fraud," Congress specified an additional form of conduct for which discharge was barred.

Indeed, *Field v. Mans*, 516 U.S. 59 (1995), on which Respondent relies extensively, undermines his interpretation of actual fraud. *Field* determined the dischargeability of a debt for particular "*conduct*"—a misrepresentation—by considering the elements of "actual fraud," as understood by the common law in 1978. *Id.* at 70 & n.9 (emphasis added).[2] That is, it treated "actual fraud" as a form of conduct and a distinct ground for discharge—not as a *mens rea* modifying the rest of § 523(a)(2)(A).

2. Respondent's efforts to transform "actual fraud" from a noun phrase referring to conduct into an adjective describing the manner in which conduct is carried out are unavailing.

---

[2] Respondent's other authorities likewise describe actual fraud as conduct in which someone engages rather than merely a mindset. Resp.Br.29-30 & n.4. Even Respondent cannot avoid that usage. Resp.Br.29 ("[A] false representation with intent to injure qualifies as 'actual fraud.'").

First, Respondent claims that *Neal* used the phrase "actual fraud" as shorthand for *mens rea*, and without reference to the kind of conduct subject to the discharge bar. But by Respondent's own account, *Neal* was a fraudulent-conveyance case that used "the term 'actual fraud' to distinguish conveyances 'involving moral turpitude or intentional wrong' from those involving 'implied fraud, or fraud in law.'" Resp.Br.46-47 (quoting *Neal*, 95 U.S. at 709). *Neal* drew that line to delineate which conduct—in particular, which types of participation in *fraudulent conveyances*—fell within the discharge bar and which did not. *See* 95 U.S. at 707-09. Of course, the Court would have had no reason to draw that line if fraudulent conveyances were categorically excluded from the discharge bar. Thus, in adding "actual fraud" to codify *Neal*, Congress codified the same line that this Court drew: The discharge bar applies to intentional fraud (including knowing participation in a fraudulent transfer), but not to constructive fraud (such as innocent participation).

Second, Respondent is likewise wrong that other cases discussing actual fraud merely "describe an intent element." Resp.Br.49. For example, *Smith v. Wilder* explained that conveyances that hinder creditor rights are a form of "fraud." 120 So. 2d 871, 882 (Ala. 1960). *Bean v. Smith* held that those who participate in a conveyance designed to hinder creditors "are parties to a meditated fraud" and are themselves liable for "actual fraud." 2 F. Cas. 1143, 1149, 1159 (C.C.D.R.I. 1821). *Sands v. Codwise* described fraudulent conveyances as "a palpable fraud" that, when "made ... to cheat creditors," constitutes "actual fraud." 4 Johns. 536, 594-96, 599

(N.Y. Sup. Ct. 1808). *See also* Pet.Br.24-29. And the knowing recipient of the transfer also commits actual fraud. *See* Pet.Br.30-32. Thus, in *Twyne's Case*, the defendant was convicted of fraud for receiving property through a transfer that he knew was designed to hinder creditors. 3 Coke Rep. 80b, 83b, 76 Eng. Rep. 809, 823 (K.B. 1601).

Finally, interpreting actual fraud to mean intentional fraud does not render § 523(a)(2)(A) "boundless." Resp.Br.36. Rather, as *Field* explains, the term "actual fraud" should be understood by reference to the recognized forms of common-law fraud in 1978. 516 U.S. at 69. That includes knowing participation in deliberate fraudulent-transfer schemes. Pet.Br.24-32.[3]

C. Respondent's Other Attempts To Defend His Distorted Construction Fail

Respondent advances a series of other unavailing arguments in an attempt to legitimize his ungrammatical reading of § 523(a)(2)(A).

1. Section 523(a)(2)(A)'s predecessor did not already cover the universe of fraud

Respondent claims that "actual fraud" must have narrowed the scope of the discharge bar because

[3] Respondent's *amici* suggest that treating intentional fraudulent transfers as actual fraud sweeps in conduct with a lesser *mens rea* than other fraud because intent may be established through circumstantial evidence. Brunstad.Am.Br.13-14; NACBT.Am.Br.5. But circumstantial evidence is *always* sufficient to prove intent to defraud, regardless of the particular form of fraud. 37 Am. Jur. 2d Fraud & Deceit §§ 483, 489 (2016).

§ 523(a)(2)(A)'s predecessor, which barred debts arising from false pretenses and false representations, already covered the universe of fraud. But as Petitioner has explained, the common law recognized numerous forms of fraud—some of which did not entail a misrepresentation, and were not covered by § 523(a)(2)(A)'s predecessor. Pet.Br.22-24.[4]

Respondent fails to distinguish cases recognizing other forms of fraud. Resp.Br.24 n.2 & 49-50. Those cases hold that conduct is "fraud" notwithstanding the lack of any misrepresentation. *Supra* 7-8; *see, e.g.*, *Wallace v. Wallace*, 291 S.E.2d 386, 388 (W Va. 1982) (conveyance intended to defeat divorcing spouse's property interest); *Cox v. Hale*, 114 So. 465, 467 (Ala. 1927) (undue influence).

Respondent incorrectly suggests that some of these cases involve only fiduciary fraud. As in *Neal*, the defendant in *Seeberg v. Norville* was not a fiduciary, yet he was liable in fraud for purchasing property (*from* a fiduciary) for what he knew to be less than fair market value. 85 So. 505, 506-07 (Ala. 1920). And in *Smith v. Harrison*, only one of the defendants was a fiduciary, but they all participated in "fraud" when they obtained a favorable judgment by threatening the opposing party. 2 Heisk. 230, 235-37 (Tenn. 1870).

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[4] Interpreting § 523(a)(2)(A)'s predecessor, this Court recognized that "liabilities for obtaining property by false pretenses or false representations" are debts "obtained by fraud," but it never suggested that "false pretenses" and "false representations" are the only kinds of fraud. *Compare Gleason v. Thaw*, 236 U.S. 558, 562 (1915), *with* Resp.Br.8.

Nor can Respondent sidestep these authorities because fraud "typically" involves a misrepresentation. Resp.Br.22 (internal quotation marks omitted). The typical form of fraud is not the only form. *See* Pet.Br.20-32. Respondent dismisses cases setting forth a broad definition of fraud if the fraud at issue ultimately involved a misrepresentation. Resp.Br.24 & n.2. But in explaining the law, those cases recognize that common-law fraud encompasses more than misrepresentations. *See, e.g.*, *Stapleton v. Holt*, 250 P.2d 451, 445 (Okla. 1952); *Chien v. Chen*, 759 S.W.2d 484, 494-95 (Tex. App. 1988). And numerous cases *hold* the same thing. *See supra* 7-9.

Respondent notes that, however the common law may have understood fraud, the Uniform Law Commission in 2014 recommended renaming the Uniform Fraudulent Transfer Act to no longer refer to fraudulent transfers as "fraud." But as *Field* instructs, the relevant inquiry is "the concept of 'actual fraud' as it was understood in 1978." 516 U.S. at 70. The Commission's recommended change in 2014 only underscores the longstanding usage of actual fraud that Congress codified in 1978. Indeed, the Commission noted that deliberately fraudulent transfers were "widely known" as "actual fraud." Unif. Voidable Transactions Act § 15, cmt.1 (Unif. Law Comm'n 2014).

Finally, Respondent cites a 1902 House Judiciary Committee report to show that "the phrase 'false pretenses or false representations'" is "coterminous" with "created by fraud." Resp.Br.7 (citing H.R. Rep. No. 57-1698, at 6 (1902)). But that report was based on an earlier draft of the 1903 amendments, which

still included the 1898 Act's reference to "frauds." *See* H.R. 13679 (1902); *see also* 36 Cong. Rec. S1035 (daily ed. Jan. 21, 1903) (recording vote "to strike out 'frauds, or'" in § 523(a)(2)(A)'s predecessor). Thus, when the Committee stated that "claims created by fraud but not reduced to judgment" would be nondischargeable, H.R. Rep. No. 57-1698 at 6, it was characterizing draft statutory language that referred to "liabilities for *frauds*," H.R. 13679 (emphasis added). This report says nothing about the scope of the 1903 discharge bar that Congress actually enacted.

2. Section 523(a)(2)(A)'s predecessor did not apply to innocent or negligent misrepresentations

Respondent surmises that Congress added "or actual fraud" to address concerns that courts might interpret "false pretenses" and "false representation" to include innocent conduct. But before 1978, false pretenses and false representation already required *intentional* misrepresentation at common law, and courts universally interpreted § 523(a)(2)(A)'s predecessor accordingly. Congress did not add "or actual fraud" "just to state an already existing rule." *Stone v. I.N.S.*, 514 U.S. 386, 397 (1995); *see* Pet.Br.34-36.

Respondent's own sources confirm that, "[t]o be guilty of the crime of false pretenses, one must .... know that his representation is false" and "have an intent to defraud." LaFave, SUBSTANTIVE CRIMINAL LAW § 19.7(f). So, too, with false representation. Petitioner and Respondent agree that "false representation" refers to the common-law tort of

deceit. Indeed, Respondent derives the elements of false representation from a treatise's discussion of "deceit." Resp.Br.25 (citing Prosser, TORTS § 105, at 684 (4th ed. 1971); *id.* § 107 at 699). The same sections of that treatise make clear that deceit required a *knowingly* false representation *intended* to induce reliance. Prosser, *supra*, § 105 at 685-86; *id.* § 107 at 699-702; *see also* Restatement (Second) Torts § 526 & cmt.d.

To be sure, some courts recognized that "statements recklessly made and statements made as of knowledge, when in fact no such knowledge exists, are ... the equivalents of conscious misrepresentations." *Vincent v. Corbitt*, 47 So. 641, 642 (Miss. 1908); *see also* 23 Am. Jur. Fraud & Deceit § 127 (1939). But these cases do not eliminate the scienter requirement; rather, they hold that reckless disregard for the facts "is the full equivalent of knowledge." Prosser, *supra*, § 107 at 705 & n.23; *see also* Restatement (Second) § 526 cmt.d. Moreover, cases that impose liability for mere *innocent* misrepresentations make clear that such conduct is *not* actionable as deceit. *See, e.g., Brown v. Underwriters at Lloyd's*, 332 P.2d 228, 233 (Wash. 1958) (en banc); *Int'l Prods. Co. v. Erie R.R. Co.*, 155 N.E. 662, 663 (N.Y. 1927); *see also* Restatement (Second) Torts §§ 525, 552A-D (distinguishing between "Fraudulent Misrepresentation (Deceit)" and negligent or innocent misrepresentations).

Respondent cites stray language from a treatise that "'[a] minority of the American courts ... have held that deceit will lie for negligent statements.'" Resp.Br.31 (quoting Prosser, *supra*, § 107 at 705). But none of the cited cases supports that

characterization. Each imposes liability for reckless statements, which are "equivalent[] [to] conscious misrepresentations." *Vincent*, 47 So. at 642-43; *see Anderson v. Tway*, 143 F.2d 95, 99 (6th Cir. 1944); *Mullen v. E. Trust & Banking Co.*, 81 A. 948, 949-50 (Me. 1911); *Watson v. Jones*, 25 So. 678, 683 (Fla. 1899); *Schoefield Gear & Pulley Co. v. Schoefield*, 40 A. 1046, 1051 (Conn. 1898).

Accordingly, courts interpreting "false pretenses" and "false representation" under § 523(a)(2)(A)'s predecessor "unanimously require[d]" "fraudulent intent or reckless disregard for the truth tantamount to willful misrepresentation." *Wright v. Lubinko*, 515 F.2d 260, 263-64 (9th Cir. 1975).[5] This consensus is no surprise: From its earliest iterations, the discharge bar has consistently been construed to apply *only* to intentionally fraudulent conduct. *See Bullock v. BankChampaign, N.A.*, 133 S. Ct. 1754, 1759-60 (2013); *Neal*, 95 U.S. at 709. That accords with the Code's longstanding policy of affording relief

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[5] *See, e.g.*, *Carini v. Matera*, 592 F.2d 378, 380 (7th Cir. 1979) (per curiam); *In re Matter of Vickers*, 577 F.2d 683, 687 (10th Cir. 1978); *Matter of McMillan*, 579 F.2d 289, 292 (3d Cir. 1978); *Ruegsegger v. McCarley*, 496 P.2d 214, 218 (Ore. 1972); *Peoples Fin. & Thrift Co. of Ogden v. Doman*, 497 P.2d 17, 19 (Utah 1972); *Swanson Petroleum Corp. v. Cumberland*, 167 N.W.2d 391, 397 (Neb. 1969); *Weigand v. Furniss*, 377 P.2d 371, 372 (Idaho 1962); *Zerega Distrib. Co. v. Gough*, 325 P.2d 894, 896 (Wash. 1958); *Horner v. Nerlinger*, 7 N.W.2d 281, 285-86 (Mich. 1943); *Slacum v. E. Shore Trust Co.*, 163 A. 119, 120 (Md. 1932); *Drake*, 128 N.W. at 319; *Sanitation Recycling, Inc. v. Jay Peak Lodging Ass'n, Inc.*, 428 F. Supp. 1022, 1024 (D. Vt. 1977); *In re Blessing*, 442 F. Supp. 68, 70 (S.D. Ind. 1977); *In re Blakesley*, 27 F. Supp. 980, 981 (W.D. Mo. 1939); *Hisey v. Lewis-Gale Hosp.*, 27 F. Supp. 20, 23 (W.D. Va. 1939).

to the "honest but unfortunate debtor." *Grogan v. Garner*, 498 U.S. 279, 287 (1991).

Against this backdrop, it is implausible that Congress added "or actual fraud" to narrow the fraud discharge bar, out of concern that § 523(a)(2)(A) might otherwise cover innocent conduct. There was no basis for concern.

3. Respondent's construction renders Congress's 1978 amendment superfluous

Finally, Respondent claims that his reading is necessary to give each statutory term meaning. But Respondent's reading does not give actual fraud any independent meaning; it merely restates the "already existing rule" that false pretenses and false representations require intent to defraud. *Stone*, 514 U.S. at 397; *see supra* 11 13. And when the choice is between depriving an amendment of *any* new meaning and giving it a meaning that both expands upon and overlaps with pre-existing statutory language, this Court repeatedly has done the latter.

In *Louisville & Nashville Railroad Co. v. Mottley*, for example, Congress added the words "or different" to a statute prohibiting common carriers from demanding or collecting compensation "greater or less" than the published tariffs. 219 U.S. 467, 475 (1911); *see also* Pet.Br.35. Congress's amendment overlapped with the pre-existing, preceding statutory phrases: Compensation "greater or less" than the published tariff is also "different." But the Court's animating concern was not to avoid overlap; it was to avoid rendering the amendment "superfluous or

meaningless." *Id.* at 475-76; *see also Pierce Cnty. v. Guillen*, 537 U.S. 129, 145 (2003).

Even outside the context of amendments, this Court does not defy grammar merely to avoid overlap. Congress often uses phrases that both overlap with and expand upon preceding terms, especially to ensure comprehensive coverage. For example, 28 U.S.C. § 2680(c) preserves sovereign immunity for claims arising from the detention of property by "any officer of customs or excise or any other law enforcement officer." *Ali* held that "any other law enforcement officer" means "law enforcement officers of whatever kind," including customs and excise officers. 552 U.S. at 220. That interpretation arguably rendered "any officer of customs or excise" superfluous. But, as the Court explained, "Congress may have simply intended to remove any doubt that officers of customs or excise were included in 'law enforcement officers.'" *Id.* at 226.

Thus, the possibility that, under Petitioner's reading, actual fraud overlaps with § 523(a)(2)(A)'s pre-existing terms does not justify Respondent's interpretation. Congress's belt-and-suspenders approach reflects its "inten[t] to remove any doubt" about the comprehensive scope of the fraud discharge bar. *Id.* By contrast, Respondent's interpretation has indefensible consequences: It deprives the 1978 amendment of any effect, defies grammar, and ignores the settled meaning of actual fraud that Congress codified.

II. SECTION 523(a)(2)(A)'S "OBTAINED BY" LANGUAGE DOES NOT REQUIRE A MISREPRESENTATION

Respondent makes much of § 523(a)(2)(A)'s requirement that a "debt ... for money [or] property [be] *obtained by*" actual fraud. From this language, he infers that § 523(a)(2)(A) applies only if the debtor obtains property directly from a creditor to whom he makes a reliance-inducing misrepresentation. In other words, he contends that § 523(a)(2)(A) excludes a transferee's debt for a fraudulent conveyance, because the discharge bar applies only to a fraudulent transaction directly between the debtor and the creditor. But "obtained by" does not impose any of these requirements.

1. The words "obtained by" require *causation*: The debtor must "acqui[re]" money or property *as a result of* fraud. *Cohen v. de la Cruz*, 523 U.S. 213, 218, 221 (1998); *see also Field*, 516 U.S. at 66 (describing "the element of causation inherent in the phrase 'obtained by'"). When a transferee receives property through a transfer that he knows is intended to defraud creditors, he commits actual fraud himself. He therefore obtains property fraudulently, i.e., by actual fraud (and that fraud also causes the creditor's loss).

To be sure, where fraud *does* involve misrepresentation, reliance is necessary to establish causation. But that is because a misrepresentation—unlike other frauds—does not cause any loss unless someone relies on it. *See* Restatement (Second) Torts § 546. It is not because "obtained by" invariably requires reliance. *See Field*, 516 U.S. at 68 n.7

("obtained by" does not "suppl[y]" an element of reliance).

2. Nor does the phrase "obtained by" require that the debtor *obtain* money or property *directly from* a creditor, or, where a misrepresentation is at issue, that it be made *directly to* the creditor. Section 523(a)(2)(A), in other words, is not limited to fraudulent transactions directly between a debtor and a creditor; it covers the full range of fraudulent conduct by which a debtor obtains money or property.

For example, *Myers v. International Trust Co.* interpreted the predecessor of § 523(a)(2)(A), which barred discharge of liabilities "'for obtaining property by false pretenses or false representations.'" 263 U.S. 64, 75 (1923) (discussing § 17a of the 1903 Act). By contrast, § 14b(3) (the predecessor of § 523(a)(2)(B)) barred discharge where a debtor had "'obtained property on credit from any person upon a materially false statement in writing *made to such person* for the purpose of obtaining such property on credit.'" *Id.* at 74 (emphasis added). *Myers* found it dispositive that, unlike § 14b(3), § 17a did not contain any "restriction as to whom [a] representation should be made." *Id.* at 75. Thus, the Court held that § 17a barred debts arising from misstatements made to a third party—not to the creditor. *Id.* at 75-76.

Other cases similarly refute Respondent's assertions that the debtor must "direct[] a false word or deed" at the creditor and "obtain something from the creditor." Resp.Br.35 (emphasis deleted). *In re Namenson* held that a debt for insurance money that the debtor obtained from a bank by forging the beneficiary's signature was nondischargeable under

§ 523(a)(2)(A)'s predecessor. 555 F.2d 1067, 1069 (1st Cir. 1977). The statute did not require that the creditor (the insurance beneficiary) rely on the misrepresentation, or that the debtor obtain money directly from the creditor. *Id.*

And when construing other language similar to § 523(a)(2)(A), this Court has repudiated constructions like Respondent's. *Loughrin* involved a provision penalizing schemes "'to *obtain* any [bank money or property] *by* means of false or fraudulent pretenses, representations, or promises.'" 134 S. Ct. at 2388 (quoting 18 U.S.C. § 1344(2)) (emphasis added). The defendant forged stolen checks, used them to purchase goods from Target, and then returned the goods for cash. *Id.* at 2387. In holding that this conduct violated the statute, *Loughrin* rejected the defendant's attempt to add an "invisible element" requiring that he make his representation to, and obtain property from, the bank rather than a third party. *Id.* at 2393.

Moreover, as these examples suggest, Respondent's interpretation of "obtained by" is not only unsupported by the statutory language; it would also leave § 523(a)(2)(A) powerless against many forms of fraud--even those in which a debtor obtains property by misrepresentations. Congress could not have intended that result. For instance, Respondent's construction of § 523(a)(2)(A) would allow a debtor who obtains an inheritance by forging a will to discharge his debt to the rightful heir because he neither obtained property from nor made a misrepresentation to that person. *See In re Freeland*, 360 B.R. 108, 122, 131 (Bankr. D. Md. 2006). A debtor who obtains property from third parties by

misrepresenting his identity could discharge any resulting debts to his victims. *See Kudelko v. Dalessio*, 829 N.Y.S.2d 839, 843 (N.Y.C. Civ. Ct. 2006). And, as Petitioner's *amici* explain, Respondent's interpretation would exclude the many Ponzi schemes where misrepresentations—and property—pass through numerous intermediaries instead of directly between the perpetrator and his victims. Bankr.Law.Prof.Am.Br.28-29.

3. Respondent insists that § 523(a)(2)(A) requires a transaction directly between the debtor and creditor because § 523(a)(2)'s *other* subsections impose such a requirement. Resp.Br.35. But nothing in § 523(a)(2)(C) requires obtaining money or property from the *creditor*. And § 523(a)(2)(B), which expressly requires that the debtor make a false statement to the creditor from whom he obtains property, only highlights the absence of similar language in § 523(a)(2)(A). *See Myers*, 263 U.S. at 75-76. Indeed, Congress's use of the word "obtain" elsewhere in the Code confirms that, when it wanted to specify "from whom," it did so. *See, e.g.*, 11 U.S.C. § 109(h)(3)(A) (discussing consequences of debtor's inability to "obtain" credit counseling services "from an approved nonprofit").

4. Finally, Respondent argues that the phrase "obtained by"—contained in § 523(a)(2)(A) but not in other discharge bars related to fraud—would be "meaningless" if it did not require obtaining something directly from a creditor. Resp.Br.34. Not so. A debtor might commit fraud without obtaining anything *from anyone* as a result—for example, by making a misrepresentation to induce someone to invest in his friend's company, Restatement (Second)

Torts § 533 cmt.d; by aiding and abetting another's fraud, *Eastern Trading Co. v. Refco, Inc.*, 229 F.3d 617, 623 (7th Cir. 2000); or by making misrepresentations that lead to a victim's physical harm, Restatement (Second) Torts § 557A. In these situations, the "obtained by" language clarifies that § 523(a)(2)(A) does not bar discharge of the debt, because the debtor has not obtained money or property as a result of his fraud. Other provisions, by contrast, sweep more broadly, barring discharge of debts "for" fraud—regardless of profit. *See* 11 U.S.C. § 523(a)(4), (11), (19).

In sum, § 523(a)(2)(A) requires only that a debtor obtain money or property as a result of actual fraud. It does not require that the debtor obtain anything directly from a creditor, or make a reliance-inducing misrepresentation to the creditor. It therefore readily encompasses a debt for money or property that a debtor obtains by his knowing participation in a fraudulent transfer, i.e., by actual fraud.

III. INTERPRETING ACTUAL FRAUD ACCORDING TO ITS COMMON-LAW MEANING DOES NOT CREATE SUPERFLUITY

Respondent is also wrong that his reading is necessary to avoid impermissible overlap between § 523(a)(2)(A) and other Code provisions.

1. As an initial matter, Respondent's concerns about overlap are misplaced. Some degree of overlap within § 523(a) is inevitable because Congress used the same words in multiple provisions. For example, several provisions bar discharge on account of "fraud." 11 U.S.C. § 523(a)(2)(A), (4), (11), (19). And two of

them apparently overlap completely because they both involve "fraud or defalcation while acting in a fiduciary capacity." *Id.* § 523(a)(4), (11). Such overlap is unsurprising because Congress sought to make doubly sure that bankruptcy would not become an "engine of fraud and corruption." Pet.Br.43-46 (internal quotation marks omitted).

Thus, this Court has recognized that the same conduct may fall within different discharge bars. In *Cohen*, 523 U.S. at 223, the Court held that punitive damages arising from fraud are nondischargeable under § 523(a)(2)(A), even though *Grogan* had previously recognized that such damages may *also* "appropriately" be "governed by § 523(a)(6)," 498 U.S. at 282 n.2. And lower courts have likewise concluded that "[t]here is no indication" that Congress intended all of the provisions in § 523(a) "to be mutually exclusive." *Printy v. Dean Witter Reynolds, Inc.*, 110 F.3d 853, 857 (1st Cir. 1997); *see Matter of Towers*, 162 F.3d 952, 954 (7th Cir. 1998); *Matter of Stokes*, 995 F.2d 76, 76-77 (5th Cir. 1993) (per curiam). Indeed, when Congress wanted to make certain provisions within § 523(a) mutually exclusive, it said so. *See* 11 U.S.C. § 523(a)(15) (excluding debts "of the kind described in [§ 523(a)(5)]"); *id.* § 523(a)(3) (excluding "debt[s] of a kind specified in [§ 523(a)(2), (4), or (6)]"); *id.* § 523(a)(2)(A) (excluding "statement[s] respecting the debtor's or an insider's financial condition," which are otherwise covered by § 523(a)(2)(B)).

Potential overlap between § 523(a)(2)(A) and the provisions Respondent cites is thus no reason to deprive § 523(a)(2)(A) of its plain meaning.

2. In any event, interpreting actual fraud according to its common-law meaning would not render § 523(a)'s other references to fraud superfluous. As Respondent himself emphasizes, these other provisions, which bar discharge "for" fraud, do not require a debtor to have *obtained* anything as a result of his fraud. *Compare* 11 U.S.C. § 523(a)(2)(A), *with id.* § 523(a)(4), (11), (19).[6] Thus, these provisions could apply in numerous situations that § 523(a)(2)(A) would not. *See supra* 19-20.

Respondent also claims that interpreting actual fraud according to its common-law meaning would create impermissible overlap between § 523(a)(2)(A) and (a)(6). But these provisions, too, serve independent functions. Section 523(a)(6) extends to "intentional torts" that do not involve any type of "fraud" at all, such as assaulting someone or setting his car on fire. *See Kawaauhau v. Geiger*, 523 U.S. 57, 61-62 (1998).

Whether § 523(a)(6) also encompasses the knowing receipt of a fraudulent transfer is hardly clear (and is not presented here). Citing only scant authority, and none from this Court, Respondent asserts that "[t]he level of intent required under § 523(a)(6) poses no obstacle" to applying that provision to fraudulent transfers. Resp.Br.44. But § 523(a)(6) requires both a "malicious" and "a deliberate or intentional injury." *Geiger*, 523 U.S. at 61 (emphasis deleted). By contrast, a participant in a fraudulent-transfer scheme commits actual fraud if he merely *knows* of

[6] These provisions also apply to more limited forms of fraud (e.g., fiduciary fraud, securities fraud) than § 523(a)(2)(A)'s "actual fraud" bar.

the transferor's fraudulent purpose; he need not "directly intend to delay or defraud creditors" himself. *Graham v. Furber*, 14 C.B. 410, 414, 418, 139 Eng. Rep. 169, 170-72 (K.B. 1854); *see* Pet.Br.30-32.[7]

Moreover, under Respondent's apparent understanding of § 523(a)(6) (Resp.Br.51, 53-54), virtually *any* conduct within § 523(a)(2)(A)—including an intentional misrepresentation that induces a creditor to give up property—would also constitute a "willful and malicious injury." This Court has cautioned against interpreting § 523(a)(6) so broadly as to swallow the other discharge bars. *Geiger*, 523 U.S. at 62. That is particularly true here. Chapter 13 debtors cannot discharge debts that fall within § 523(a)(2)(A)'s specific fraud provisions, but they generally can discharge debts that fall within § 523(a)(6). *See* 11 U.S.C. § 1328(a)(2). Shifting debts arising from fraud from § 523(a)(2)(A) to § 523(a)(6) would thwart Congress's determination—

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[7] Petitioner's failure to prevail on its § 523(a)(6) claim is not dispositive of its claim under § 523(a)(2)(A). *See* Resp.Br.53. First, Petitioner focused this litigation on § 523(a)(2)(A) rather than § 523(a)(6). Pet.App.96a (noting that "Husky's complaint makes a glancing reference to 11 U.S.C. § 523(a)(6)," which "is not enough to preserve a claim under this provision"); Pet.App.18a ("'no exhibits were introduced'" and "'no testimony was adduced'" regarding § 523(a)(6)). Second, whatever the lower courts' findings regarding § 523(a)(6), they have no bearing on § 523(a)(2)(A); if they did, the Fifth Circuit would not have had to consider whether § 523(a)(2)(A) requires a misrepresentation at all. Finally, whether Petitioner has proven the *facts* needed to satisfy § 523(a)(2)(A) under the proper legal standard is a question best decided by the courts below on remand, not by this Court in the first instance. Pet.Br.53-54.

even under Chapter 13—that "the interest in protecting victims of fraud" outweighs "the interest in giving perpetrators of fraud a fresh start," *Grogan*, 498 U.S. at 287; *see* Pet.Br.46, 52.

3. Finally, Respondent asserts that Petitioner's reading of § 523(a)(2)(A) contravenes §§ 727(a)(2) and 548(a)(1). *See* 11 U.S.C. § 727(a)(2) (barring discharge where debtor transfers property away from creditors); *id.* § 548(a)(1) (permitting trustee to avoid certain fraudulent transfers). But neither provision provides any recourse when the recipient of a fraudulent conveyance has dissipated the assets or otherwise refuses to turn them over, much less when that individual *himself* declares bankruptcy.[8] *See, e.g.*, *McClellan v. Cantrell*, 217 F.3d 890, 892 (7th Cir. 2000). Moreover, a creditor has no independent recourse under § 548(a)(1), which can be invoked only by the trustee of a transferor's bankrupt estate. Accordingly, far from conflicting with §§ 727(a)(2) or 548(a)(1), § 523(a)(2)(A) complements them by providing another means of ensuring that victims of fraud are made "whole." *Cohen*, 523 U.S. at 222.

CONCLUSION

The judgment below should be reversed, and the case should be remanded for further proceedings.

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[8] Respondent agrees that § 727(a)(2) does not apply to recipients, Resp.Br.42, and his *amici*'s contrary suggestion lacks any basis, *see* Prof.Am.Br.17-18.

Respectfully submitted,

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In the Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC.,
PETITIONER

v.

DANIEL LEE RITZ, JR.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

The Bankruptcy Code bars a debtor from discharging any "debt" "for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by * * * false pretenses, a false representation, or actual fraud." 11 U.S.C. 523(a)(2)(A). The question presented is as follows:

Whether the "actual fraud" bar to discharge in Section 523(a)(2)(A) applies when the debtor has deliberately obtained money through a fraudulent-transfer scheme that was intended to cheat a creditor, even though the scheme did not involve the use of a false representation to induce the creditor to turn over money or property.

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In the Supreme Court of the United States

No. 15-145

HUSKY INTERNATIONAL ELECTRONICS, INC.,
PETITIONER

v.

DANIEL LEE RITZ, JR.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES
AS AMICUS CURIAE SUPPORTING PETITIONER

INTEREST OF THE UNITED STATES

The question presented in this case concerns the scope of the "actual fraud" bar to discharge in Section 523(a)(2)(A) of the Bankruptcy Code, 11 U.S.C. 523(a)(2)(A). The United States is the largest creditor in the Nation, and federal agencies frequently appear as creditors in bankruptcy cases. Congress has empowered a number of agencies to enforce federal statutory prohibitions on fraud. Those agencies invoke Section 523(a)(2)(A) in adversary proceedings to defend their monetary judgments from discharge in bankruptcy.

In addition, the Attorney General appoints United States Trustees, who are Justice Department officials, to supervise the administration of bankruptcy cases and to oversee trustees in regions comprising the vast majority of the federal judicial districts. 28 U.S.C.

581-589a. "The United States trustee may raise and may appear and be heard on any issue in any case or proceeding" brought under the Bankruptcy Code. 11 U.S.C. 307. United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 595, 95th Cong., 1st Sess. 88 (1977). Both as creditor and as superintendent of the bankruptcy system, the United States therefore has a substantial interest in this Court's resolution of the question presented.

STATUTORY PROVISIONS INVOLVED

Pertinent statutory provisions are reproduced in the appendix to this brief. App., *infra*, 1a-6a.

STATEMENT

1. The federal bankruptcy system is intended to give the honest but unfortunate debtor a fresh start while ensuring the maximum possible equitable distribution to creditors. See, *e.g.*, *Stellwagen* v. *Clum*, 245 U.S. 605, 617 (1918); *Williams* v. *United States Fid. & Guar. Co.*, 236 U.S. 549, 554-555 (1915). In balancing those sometimes competing goals, Congress has enacted various provisions that prevent or limit the discharge in bankruptcy of debts that arise from a debtor's fraudulent acts. Such provisions reflect Congress's evident determination that "creditors' interest in recovering full payment of [certain] debts * * * outweighed the debtors' interest in a complete fresh start." *Grogan* v. *Garner*, 498 U.S. 279, 287 (1991).

Section 523 of the Bankruptcy Code declares various categories of debts ineligible for discharge. 11 U.S.C. 523. As relevant here, Section 523 provides that a discharge under Chapter 7, 11, 12, or 13 of the Bankruptcy Code "does not discharge an individual debtor from any debt * * * for money, property, [or]

services, * * * to the extent obtained by * * * false pretenses, a false representation, or actual fraud." 11 U.S.C. 523(a)(2)(A). The question presented in this case concerns the scope of the "actual fraud" exception to discharge.

2. From 2003 to 2007, petitioner (a seller of electronic-device components) sold merchandise to Chrysalis Manufacturing Corporation. Pet. App. 2a. At all relevant times, respondent financially controlled Chrysalis, served as a director of Chrysalis, and owned at least 30% of Chrysalis's common stock. *Ibid.*

Chrysalis failed to pay for all of the items it had purchased from petitioner, accruing a debt of $163,999.38. Pet. App. 2a. During the relevant time period, Chrysalis also failed to pay other debts as they came due. *Id.* at 3a. While Chrysalis accrued such unpaid debts, respondent caused the corporation to transfer more than $1 million to seven other corporate entities, at least five of which respondent controlled in whole or in part. *Id.* at 2a. With respect to each of those transfers, Chrysalis did not receive reasonably equivalent value in exchange. *Id.* at 3a, 81a-82a.

3. Petitioner sued respondent in federal district court, seeking to hold him personally liable for the $163,999.38 debt that Chrysalis owed. Pet. App. 3a. Petitioner brought that claim under Section 21.223(b) of the Texas Business Organizations Code Annotated, under which a shareholder may be held liable for a corporation's contractual obligations if the shareholder "caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder." *Id.* at 36a (citation omitted). Respondent then filed a voluntary petition for Chapter 7 bank-

ruptcy in the Southern District of Texas. *Id.* at 3a. Petitioner initiated an adversary proceeding in the bankruptcy court, arguing, *inter alia*, that 11 U.S.C. 523(a)(2)(A) barred respondent from discharging his debt to petitioner because the debt was one "for money * * * obtained by * * * actual fraud."[1] *Ibid.*

a. After holding a trial, the bankruptcy court granted judgment for respondent. Pet. App. 78a-98a. The court found that respondent had "drained substantial funds out of Chrysalis's operating account and funneled these funds to other entities [he] controlled." *Id.* at 98a. The court further found that none of the disputed transfers had provided Chrysalis with "reasonably equivalent value," *id.* at 81a-82a, and that respondent was "not a credible witness" due to his "blatantly contradictory" attempts to explain his behavior and his "evasiveness and obfuscation" on the stand, *id.* at 83a-85a.

The bankruptcy court nevertheless held that petitioner was not entitled under Texas law to pierce the corporate veil and recover Chrysalis's debt from respondent. Pet. App. 90a-98a. The court observed that Texas law permits shareholder liability for a corporation's debt only when the shareholder has "perpe-

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[1] In addition to invoking Section 523(a)(2)(A), petitioner alleged that respondent's debt was non-dischargeable because it was "for fraud * * * while acting in a fiduciary capacity," 11 U.S.C. 523(a)(4), and because it was "for willful and malicious injury by the debtor to" petitioner or its property, 11 U.S.C. 523(a)(6). The bankruptcy court rejected both arguments. Pet. App. 93a-97a. Petitioner appealed the bankruptcy court's Section 523(a)(6) holding to the district court and the court of appeals, both of which affirmed. *Id.* at 17a-19a, 74a-77a. Petitioner did not seek this Court's review of that aspect of the court of appeals' decision. See Pet. i.

trate[d] an actual fraud" on the creditor. *Id.* at 91a (quoting Tex. Bus. Orgs. Code Ann. § 21.223(b) (West 2012)). The court found the record to be "wholly devoid" of evidence of what the court considered to be "the most crucial element for establishing actual fraud," *viz.* a false representation by the debtor to the creditor. *Id.* at 92a. The court also stated that "the tests for fraud under section 2[1].223 of [the Texas Business Organizations Code] and the requirements of section 523(a)(2)(A) of the [Bankruptcy] Code are virtually the same." *Ibid.* The bankruptcy court "conclude[d] that [petitioner's] common law fraud cause of action must fail and, therefore, [petitioner] may not prevail under [11 U.S.C.] 523(a)(2)(A)." Pet. App. 93a.

b. The district court reversed the bankruptcy court's state-law ruling. The court concluded that the showing of "actual fraud" that Texas law requires in order to pierce the corporate veil need not include proof of a misrepresentation. See Pet. App. 66a-72a. In holding that the Texas Business Organizations Code Annotated "applies here to impose liability on [respondent], individually," the district court relied on the bankruptcy court's finding that respondent had "caused Chrysalis to be used for the purpose of perpetrating and did perpetrate an actual fraud on its creditors primarily for [respondent's] direct personal benefit, i.e., he drained Chrysalis of funds and fraudulently transferred those funds to other entities under his control and/or ownership." *Id.* at 68a-69a.

The district court further held, however, that respondent's debt to petitioner did not fall within the exception to discharge in 11 U.S.C. 523(a)(2)(A). Pet. App. 72a-74a. The court relied on circuit precedent

holding that, for purposes of Section 523(a)(2)(A), "false pretenses, false representations[,] and actual fraud" have identical elements, one of which is a false representation. *Id.* at 72a-73a (citing *General Elec. Capital Corp.* v. *Acosta*, 406 F.3d 367, 372 (5th Cir. 2005)).

c. The court of appeals affirmed. Pet. App. 1a-20a. The court adhered to circuit precedent that had narrowly construed the term "actual fraud" in Section 523(a)(2)(A) to require proof that the debtor had made a false representation on which the creditor relied. See *id.* at 13a. The court acknowledged that such an interpretation renders the phrase "actual fraud" in Section 523(a)(2)(A) "redundant." *Id.* at 14a. The court of appeals reasoned, however, that this Court's decision in *Field* v. *Mans*, 516 U.S. 59 (1995), "[a]lthough not directly addressing the issue, appeared to assume that a false representation is necessary to establish 'actual fraud.'" Pet. App. 10a. In light of its holding as to dischargeability, the court of appeals declined to decide whether respondent had engaged in "actual fraud" within the meaning of Section 21.223(b) of the Texas Business Organizations Code. *Id.* at 6a.

SUMMARY OF ARGUMENT

The court of appeals held that the term "actual fraud" in 11 U.S.C. 523(a)(2)(A) is limited to illicit schemes involving false representations. That holding is contrary to the established understanding of the term "actual fraud" and to the structure and purposes of the Bankruptcy Code's non-dischargeability provisions.

A. Because the Code does not define the term "actual fraud," the Court should look to its established

common-law meaning. This Court held in *Neal* v. *Clark*, 95 U.S. 704, 709 (1877), that the term "fraud" in the bankruptcy context means positive fraud involving moral turpitude or intentional wrong. Congress's use of the term "actual fraud" in Section 523(a)(2)(A) is best understood to carry that meaning.

1. English and American courts have long viewed conveyances that are intended to delay or prevent collection of an existing debt as a species of fraud, even though such schemes usually do not involve a false representation. In 1571, British Parliament codified existing common law on fraudulent transfers by enacting the Statute of 13 Elizabeth, which voided conveyances made with the purpose or intent to delay, hinder, or defraud. More than a century ago, this Court described the standard set forth in that law as requiring proof of "actual fraud." In construing the various fraud provisions that Congress has included in bankruptcy statutes stretching back to the Nineteenth Century, this Court has never suggested that the requisite intent to defraud may be established only with proof that a false representation induced a creditor to part with money or property.

By the time Congress enacted the Bankruptcy Code in 1978, it was well established that the term "actual fraud" in this context encompassed schemes that do not employ a false representation, including fraudulent-transfer schemes. The courts often applied that principle to determine whether transferred property should be returned to the estate, rather than (as here) in determining whether any debt the transferee incurred as a result of the scheme was dischargeable. Those authorities nevertheless bear directly on the proper construction of Section

523(a)(2)(A), because they reflect the longstanding recognition by legislatures and this Court that a conveyance intended to cheat a creditor is a form of "actual fraud." When a transferee shares the transferor's intent to hinder, delay, or defraud the transferor's creditor, the money or property the complicit transferee receives is "obtained by * * * actual fraud" within the meaning of Section 523(a)(2)(A), regardless of whether the scheme involves a false representation to the creditor.

The court of appeals' reliance on this Court's decision in *Field* v. *Mans*, 516 U.S. 59 (1995), was misplaced. Because the creditors in *Field* alleged that the debtors had used false representations to obtain credit, the Court focused on the common-law rules governing (and particularly on the degree of reliance needed to establish) that *type* of fraudulent scheme. The Court's analysis does not suggest that a false representation is an essential prerequisite to *every* form of "actual fraud."

2. In a typical fraudulent-conveyance case, the transferor attempts to cheat his creditors by creating the appearance that he lacks sufficient assets to pay his debt and obtaining a discharge of that debt in bankruptcy. State fraudulent-conveyance laws often create a cause of action against a transferee who knowingly participates in a fraudulent-transfer scheme. Where state law renders the complicit transferee liable, the transferee's resulting debt is one for money or property "obtained by * * * actual fraud" within the meaning of Section 523(a)(2)(A) and therefore is non-dischargeable.

In this case, petitioner seeks to hold respondent personally liable for a debt owed by Chrysalis, the

transferor corporation that respondent controlled. In order to establish the Texas-law prerequisites to piercing Chrysalis's corporate veil, however, petitioner must show that respondent used the transferred funds for his direct personal benefit, by sending them to other corporations that he controlled. If petitioner can establish that prerequisite to state-law liability, respondent's debt is correctly viewed as one for money "obtained by * * * actual fraud." In holding to the contrary, the court of appeals did not consider whether respondent should be viewed as the transferee or transferor. Rather, the court employed an incorrectly limited view of "actual fraud" that would apply equally to the more typical case in which the debtor seeking a bankruptcy discharge is solely the recipient of a fraudulent conveyance.

B. Section 523(a)(2)(A) identifies "actual fraud" and "a false representation" as separate bases for denying discharge. That language reinforces the conclusion that "actual fraud" is not limited to schemes involving a "false representation." The court of appeals inferred that, because other provisions in the Code address (or may address) fraudulent transfers, Congress could not have intended fraudulent-transfer schemes to be covered by Section 523(a)(2)(A). That reasoning was faulty. The provisions on which the court relied address different problems, and they will not be rendered superfluous if Section 523(a)(2)(A) is construed to encompass fraudulent-transfer schemes. And the *possibility* of some overlap between different non-dischargeability rules provides no sound basis for rejecting the established meaning of the term "actual fraud."

C. Section 523(a)(2)(A) reflects Congress's policy determination that an individual who owes a debt for money or property obtained by fraud is not the type of honest but unfortunate debtor who is entitled to the benefits of the bankruptcy system. That determination reflects the broader understanding that equitable principles govern the exercise of bankruptcy jurisdiction, and that a creditor's right to recovery is paramount in the face of a debtor's dishonesty. Correctly interpreting Section 523(a)(2)(A) to apply to fraudulent-transfer schemes protects creditors without burdening honest debtors.

ARGUMENT

THE BANKRUPTCY CODE'S BAR TO DISCHARGE OF A DEBT FOR MONEY OR PROPERTY OBTAINED BY "ACTUAL FRAUD" ENCOMPASSES DEBTS FOR MONEY OR PROPERTY THAT WAS OBTAINED THROUGH INTENTIONALLY FRAUDULENT SCHEMES THAT DO NOT INVOLVE A FALSE STATEMENT OR FALSE REPRESENTATION

"The Bankruptcy Code has long prohibited debtors from discharging liabilities incurred on account of their fraud, embodying a basic policy animating the Code of affording relief only to an 'honest but unfortunate debtor.'" *Cohen* v. *Cruz*, 523 U.S. 213, 217 (1998) (quoting *Grogan* v. *Garner*, 498 U.S. 279, 287 (1991)). Section 523(a)(2)(A) of the Bankruptcy Code prohibits the discharge of "any debt" for, *inter alia*, money or property to the extent such money or property was "obtained by * * * false pretenses, a false representation, or actual fraud." 11 U.S.C. 523(a)(2)(A); see *Cohen*, 523 U.S. at 218-219 ("Once it is established that specific money or property has

been obtained by fraud, * * * 'any debt' arising therefrom is excepted from discharge.").

The court of appeals held that, even assuming that petitioner can satisfy the Texas-law requirements to pierce the corporate veil and hold respondent personally liable for Chrysalis's contractual obligations, Section 523(a)(2)(A) does not preclude discharge of respondent's debt because the fraudulent scheme alleged in this case did not involve any false representation to petitioner. That holding is erroneous. Dishonest transfers used to hinder or defeat creditors' efforts to collect debts from the transferor have long been viewed as a species of "actual fraud." Section 523(a)(2)(A) is properly construed, in light of its text and history, to incorporate that traditional understanding.

A. When A Debtor Has Obtained Money By Means Of A Fraudulent Conveyance, Acting With Knowledge Of The Transferor's Fraudulent Intent, Any Debt Associated With That Money Is Non-dischargeable Under Section 523(a)(2)(A)

Section 523 of the Bankruptcy Code prevents discharge in bankruptcy of a debt for money or property to the extent the money or property was obtained by "false pretenses, a false representation, or actual fraud." 11 U.S.C. 523(a)(2)(A). The court of appeals held that "actual fraud" within the meaning of that provision can occur only if the debtor makes a false representation to the creditor. Pet. App. 6a-7a. Respondent elaborates on that standard, arguing that a debtor's actions qualify as "actual fraud" only if the debtor employed a false statement or misrepresentation to induce a creditor to part with money or property. Br. in Opp. 16-21. That interpretation is incorrect.

1. At common law, the term "actual fraud" referred to intentional frauds, including schemes to transfer assets in order to thwart creditors' collection efforts, regardless of whether those schemes involved a false representation to the victim

Although the Bankruptcy Code does not define the term "actual fraud," this Court has "construe[d] the terms in § 523(a)(2)(A) to incorporate the general common law of torts." *Field* v. *Mans*, 516 U.S. 59, 70 n.9 (1995). The Court in *Field* explained more generally that, when "Congress uses terms that have accumulated settled meaning under . . . the common law, a court must infer, unless the statute otherwise indicates, that Congress meant to incorporate the established meaning of these terms." *Id.* at 69 (quoting *Community for Creative Non-Violence* v. *Reid*, 490 U.S. 730, 739 (1989)). Contrary to the court of appeals' conclusion, that interpretive methodology does not support the view that "actual fraud" requires the use of false representations.

a. From its inception, American bankruptcy law has incorporated the concept of fraud for various purposes. In *Neal* v. *Clark*, 95 U.S. 704, 709 (1877), this Court held that the term "fraud," as used in the bankruptcy context, "means positive fraud, or fraud in fact, involving moral turpitude or intentional wrong, * * * and not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality." When Congress enacted the Bankruptcy Code in 1978, the drafters explained that Section 523(a)(2)(A) "is intended to codify current case law, e.g., *Neal* v. *Clark*, which interprets 'fraud' to mean actual or positive fraud rather than fraud implied in law." 11 U.S.C. 523 note (citation omitted); see

McClellan v. *Cantrell*, 217 F.3d 890, 894 (7th Cir. 2000) (noting that the term "fraud in fact" is synonymous with "actual fraud"). Thus, an actual fraud for purposes of Section 523(a)(2)(A) is a fraud "involving moral turpitude or intentional wrong." *Neal*, 95 U.S at 709; accord *Ames* v. *Moir*, 138 U.S. 306, 311 (1891).

b. "Actual fraud" at common law was not limited to schemes involving the use of false representations to induce the victim to part with money or property. The essence of a common-law scheme to defraud is the use of deceit to cheat another. See 4 *Collier on Bankruptcy* ¶ 523.08[1][e], at 523-7 (Alan N. Resnik & Henry J. Sommer eds., 16th ed. 2015). Although such schemes *usually* involve the use of false representations to acquire money or property from the victim, the concept of actual fraud has not been limited to that form of illicit conduct. For centuries, English and American courts and legislatures have understood the universe of intentional (*i.e.*, actual) frauds to include conveyances that are intended to delay or prevent collection of existing debts. As the terms "fraudulent transfer" and "fraudulent conveyance" indicate, such schemes have traditionally been viewed as a species of fraud even though they typically do not involve misrepresentations to, or attempts to acquire additional money or property from, the creditors who are their victims.

In 1571, British Parliament enacted the Statute of 13 Elizabeth, which included an "Acte agaynst fraudulent Deedes Gyftes Alienations, &c." that voided "faigned covenous and fraudulent * * * Conveyaunces" made with the "Purpose and Intent to delaye hynder or defraude." 13 Eliz c. 5. That statute codified the English courts' common-law rule with respect to fraudulent conveyances, see *Sumner* v.

Hicks, 67 U.S. (2 Black) 532, 533-534 (1863), a rule that was later "universally adopted in American law as the basis of [the Nation's] jurisprudence on that subject," *Peters* v. *Bain*, 133 U.S. 670, 685 (1890). "English courts soon developed the doctrine of 'badges of fraud': proof by a creditor of certain objective facts (for example, a transfer to a close relative, a secret transfer, a transfer of title without transfer of possession, or grossly inadequate consideration) would raise a rebuttable presumption of actual fraudulent intent." *BFP* v. *Resolution Trust Corp.*, 511 U.S. 531, 540-541 (1994) (citation omitted). More than a century ago, the Court described the standard set forth in the Statute of 13 Elizabeth as requiring proof of "actual fraud." *Coder* v. *Arts*, 213 U.S. 223, 242 (1909) (construing Section 67e of the Bankruptcy Act of 1898); see *BFP*, 511 U.S. at 541 (explaining that "the 1898 Act specifically adopted the language of the Statute of 13 Elizabeth").[2]

c. "Every American bankruptcy law has incorporated a fraudulent transfer provision." *BFP*, 511 U.S. at 541. When inquiring whether a debtor (or a defendant in a non-bankruptcy proceeding) had engaged in a fraudulent conveyance, this Court has never suggested that the requisite intent to defraud may be proved only through evidence that a false representa-

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[2] When the Court decided *Coder*, Section 67e of the Bankruptcy Act of 1898 authorized avoidance of transfers made "with the intent and purpose * * * to hinder, delay, or defraud" creditors. Act of July 1, 1898, ch. 541, § 67e, 30 Stat. 564. That language was later moved to Section 67d(2)(d), and other provisions were added to make other transfers avoidable as fraudulent in law. The provision authorizing avoidance of transfers made "to hinder, delay, or defraud" a creditor is now codified at 11 U.S.C. 548(a)(1)(A).

tion induced (or was intended to induce) a creditor to part with money or property. Rather, the Court has examined the particulars of each case to discern whether the transfer was intended to cheat the creditor.

In *Thompson* v. *Baker*, 141 U.S. 648 (1891), for example, this Court interpreted a state fraudulent-conveyance statute similar to the Statute of 13 Elizabeth. *Id.* at 650. The defendant had conveyed real property to his nephew for no consideration at a time when the defendant owed $10,000 to the plaintiff. *Id.* at 648-649. The Court held that the fraudulent-conveyance statute voided the transfer (and that the plaintiff therefore had a $10,000 lien on the property when the nephew took ownership) because the "transaction" transferring title "was a mere sham" that was "made with the intent to defraud the creditors of the grantor." *Id.* at 654. Similarly in *Parish* v. *Murphree*, 54 U.S. (13 How.) 92 (1852), the Court held that a man's conveyance of property to his wife at a time when his debts exceeded his remaining assets was void under a state fraudulent-conveyance statute. The Court reached that conclusion, not because the debtor had made a false representation to his creditors, but because "no prudent man with an honest purpose and a due regard to the rights of his creditors, could have made the settlement." *Id.* at 100.

In interpreting American common-law and statutory bans on fraudulent conveyances, this Court (like its English forebears) has looked for "badges of fraud" to discern whether a debtor had the requisite state of mind—*i.e.*, whether he committed "actual fraud." In *Sexton* v. *Wheaton*, 21 U.S. (8 Wheat.) 229 (1823), for example, the Court considered the validity

of a debtor's transfer of property to his wife in the face of a creditor's demand that the property be sold to satisfy the husband's debts. *Id.* at 238-239. After noting that the debtor's wife had neither made false representations nor countenanced any false representations by her husband, the Court inquired whether "any badges of fraud attend[ed]" the transfer. *Id.* at 250-251 (considering, *inter alia*, the "proportional magnitude of the [assets] conveyed" and the "short period" between the transfer and the failure of the debtor's business). The Court declined to invalidate the transfer only after weighing those relevant facts—an exercise that would have been unnecessary if "actual fraud" required a false representation. The Court followed a similar path in *Thompson*, invalidating a fraudulent transfer "made with the intent to defraud the creditors of the grantor" despite the absence in the record of proof of any false representation. 141 U.S. at 648-649, 654.

d. Thus, by the time Congress enacted the Bankruptcy Code in 1978, it was well established that the term "actual fraud" in this context encompassed schemes that do not employ false representations, and specifically transfers undertaken with the intent to cheat creditors by thwarting their collection efforts.[3] To be sure, the statutory provisions addressed in those cases typically authorized trustees to avoid and

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[3] In addition, the Uniform Fraudulent Conveyance Act of 1918 included a section titled "Conveyance Made With Intent to Defraud," which provided that "[e]very conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors." § 7, 7A U.L.A. Pt. 2, at 378 (2006).

thereby recover fraudulent transfers made by the debtor in bankruptcy. Provisions like the current 11 U.S.C. 548(a)(1)(A), which define the circumstances under which such transfers may be avoided and the relevant property returned to the estate, do not speak to the distinct question whether any debt the *transferee* may owe as a result of such schemes is dischargeable if the transferee seeks bankruptcy relief. Those provisions (and this Court's decisions construing them) nevertheless bear directly on the question presented here, because they reflect the longstanding recognition by Congress and the Court that conveyances intended to cheat creditors are a form of "actual fraud."

In one significant respect, the inquiry under Section 523(a)(2)(A) differs from the inquiry under provisions like Section 548(a)(1)(A), which authorizes the trustee to avoid certain transfers made "with actual intent to hinder, delay, or defraud" creditors. Cases may arise in which a debtor transfers money or property with the intent to cheat his creditors, but the recipient is unaware of that purpose and therefore is not complicit in the fraud. Such transfers (if carried out within the two-year period before the filing of the bankruptcy petition) are covered by Section 548(a)(1)(A), which focuses on the intent with which the transfer was "made." Section 523(a)(2)(A), by contrast, refers to money or property "obtained by * * * actual fraud." That provision is triggered only if the *transferee* (the person who has "obtained" the money or property) acted with fraudulent intent. See *In re Lawson*, 791 F.3d 214, 222 (1st Cir. 2015) ("We hold that the fraud exception to discharge codified at § 523(a)(2)(A) continues to bar from discharge debts

incurred through knowing and intentional receipt of fraudulent conveyances."), petition for cert. pending, No. 15-113 (filed July 24, 2015); *McClellan*, 217 F.3d at 894-895. But the fact that the transferee's intent is crucial under Section 523(a)(2)(A) does not mean that a *different* intent is required. The requisite fraudulent intent may be established through proof that the transferee understood and shared the transferor's purpose of evading collection of the transferor's debt, regardless of whether any false representation to creditors was used to carry out the scheme.

e. In concluding that "actual fraud" is limited to fraudulent schemes employing a false representation, the court of appeals relied in large part on this Court's decision in *Field* v. *Mans*, *supra*. Pet. App. 9a-13a. The debtor in *Field* had made false representations to induce others to extend him credit. 516 U.S. at 61-63. The question before the Court concerned the degree of reliance on the false representations that the creditors were required to show in order to establish that the associated debt was non-dischargeable under Section 523(a)(2)(A). *Id.* at 63, 66. The Court looked to the common-law concept of "actual fraud" involving false representations to answer that question, concluding that, at common-law, such fraudulent schemes required justifiable reliance (rather than the more demanding reasonable reliance) to qualify as actual fraud. *Id.* at 69-76.

Because the creditors in *Field* had alleged a fraudulent scheme involving false representations, the Court looked to discussions in common-law and secondary sources of the circumstances under which misrepresentations will give rise to liability for fraud. 516 U.S. at 70-72. The court below viewed this Court's

focus on those discussions as indicating that a misrepresentation is an essential element of "actual fraud." Pet. App. 11a-12a. The more natural inference, however, is that the Court, in seeking to identify the relevant common-law rule, focused specifically on the law governing liability for false representations because that was the type of fraud alleged in the case. See, *e.g.*, 3 Restatement (Second) of Torts §§ 537, 540, 541, 545A, at 80, 88, 100 (1977) (in chapter on "Fraudulent Misrepresentation"); William L. Prosser, *Law of Torts* § 108, at 714 (4th ed. 1971) (in chapter on "Misrepresentation"); 1 Fowler V. Harper & Fleming James, Jr., *Law of Torts* § 7.12, at 580 (1956) (in chapter on "Misrepresentation and Nondisclosure") (all cited in *Field*, 516 U.S. at 70-72). Nothing in the scholarly works on which the Court relied suggests that the term "actual fraud" is limited to frauds involving false representations. See *Lawson*, 791 F.3d at 219 (noting that "the common law concept of 'fraud' as distilled by the Restatement to which the Court [in *Field*] directs us extends beyond fraudulent misrepresentations to at least include fraudulent conveyances").

The inference drawn by the court of appeals in this case is particularly unwarranted in light of the reason the *Field* Court gave for treating the historical materials as relevant to its interpretation of Section 523(a)(2)(A). The Court in *Field* noted and relied on the established interpretive principle that statutory terms with a common-law ancestry will be given their common-law meaning unless Congress has manifested a contrary intent. See 516 U.S. at 67. The Court's focus on the level of reliance required for "actual fraud" in common-law misrepresentation cases was simply one application of that general interpretive

rule. See *id.* at 67-68. As explained above, abundant historical evidence makes clear that common-law "actual fraud" extended beyond schemes involving false representations and encompassed conveyances designed to cheat creditors by hindering their collection efforts. To read *Field* as giving the term a narrower meaning within the context of Section 523(a)(2)(A) would turn the decision against itself.

2. If petitioner can establish the prerequisites to corporate veil-piercing under Texas law, respondent's debt to petitioner will be non-dischargeable under Section 523(a)(2)(A)

In a classic fraudulent-transfer scheme, an individual who owes a debt transfers an asset to a known individual for little or no consideration, with the intent either to reclaim the asset later or to allow the known transferee (instead of the creditor) to use the asset. Such transfers may impede collection efforts by creating the appearance that the transferor lacks sufficient assets to pay his creditor. If the transferor files a petition for bankruptcy and his fraudulent transfer is not discovered, he will obtain a discharge of his debt unless the Bankruptcy Code exempts the creditor's claim from discharge. And while the Code authorizes bankruptcy trustees to avoid certain fraudulent transfers, that power exists only with respect to transfers made within the two-year period before the bankruptcy petition was filed. See 11 U.S.C. 548(a)(1)(A).[4]

In many fraudulent-conveyance cases, a creditor seeks to recover what it is due by pursuing a remedy

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[4] In addition, 11 U.S.C. 544(b) authorizes a trustee to bring a fraudulent-transfer claim when authorized by state law, which may afford a longer limitations period.

against the transferee (who was enriched by the transfer) rather than against the transferor (whom the transfer may have rendered judgment-proof). Such a remedy may be available under a state fraudulent-conveyance statute or similar law, particularly if the transferee participated in the conveyance with the intent to assist the transferor in cheating the creditor. If the transferee seeks a discharge in bankruptcy of that state-law debt, the creditor may argue that the debt is non-dischargeable under 11 U.S.C. 523(a)(2)(A) because it is one for money or property "obtained by * * * actual fraud."

In the other court of appeals cases that gave rise to the circuit split on the question presented here, the affected creditor sought monetary relief from the recipient of an allegedly fraudulent conveyance, that transferee then filed a bankruptcy petition, and the creditor argued in the bankruptcy case that the transferee's debt was non-dischargeable under Section 523(a)(2)(A). See *Lawson*, 791 F.3d at 216-217; *McClellan*, 217 F.3d at 892. In *McClellan*, for example, the creditor (McClellan) alleged that the debtor had transferred machinery to his sister for $10; that the sister "in accepting the transfer of the machinery was colluding with her brother to thwart McClellan's collection of the debt that her brother owed him"; and that the sister "turned around and sold the machinery for $160,000—and she's not telling anyone what has happened to that money." 217 F.3d at 892. The Seventh Circuit held that, if McClellan could prove his allegations, any debt the sister owed him under Illinois's fraudulent-conveyance statute would be non-dischargeable under Section 523(a)(2)(A). See *id.* at 892-895. In holding that the alleged scheme would

constitute "actual fraud" within the meaning of that provision, the court observed that "[t]he two-step routine that McClellan alleges * * * —in which Debtor A transfers valuable property to B for nothing in order to keep it out of the hands of A's creditor and B then sells the property and declares bankruptcy in an effort to shield herself from liability for having colluded with A to defeat the rights of A's creditor—is as blatant an abuse of the Bankruptcy Code as we can imagine." *Id.* at 893.[5]

In both *Lawson* and *McClellan*, creditors asserted state-law claims against transferees who were alleged to have received property from their relatives with knowledge of the transferors' illicit intent. See *Lawson*, 791 F.3d at 216-217; *McClellan*, 217 F.3d at 892-893. Petitioner's state-law claim against respondent rests on a somewhat different conceptual footing. Petitioner sought to hold respondent personally liable for Chrysalis's breach of contract by piercing Chrysalis's corporate veil. See J.A. 88-98 (adversary complaint). Texas law permits corporate veil-piercing

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[5] Texas law provides that a transfer made by a debtor is fraudulent as to a creditor when, *inter alia*, the transfer is made "with actual intent to hinder, delay, or defraud any creditor of the debtor." Tex. Bus. & Comm. Code Ann. § 24.005(a)(1) (West 2015). A creditor who establishes that such a fraudulent transfer has occurred is entitled under Texas law to various remedies, including avoidance of the transfer, "an attachment or other provisional remedy against the asset transferred or other property of the transferee," or "any other relief the circumstances may require." *Id.* § 24.008(a)(1)-(3). Under those provisions, petitioner might have been able to establish a state-law right to monetary relief from the corporations to which Chrysalis transferred its assets, and potentially from respondent in his personal capacity by piercing the veils of those corporations.

when "a holder, beneficial owner, subscriber, or affiliate" of a corporation has "caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder, beneficial owner, subscriber, or affiliate." Tex. Bus. Orgs. Code Ann. § 21.223(b) (West 2012). Insofar as petitioner sought to hold respondent personally liable for Chrysalis's debt, based on respondent's status as Chrysalis's controlling officer, the suit might reasonably be viewed as one against respondent in his capacity as *transferor*. Because Section 523(a)(2)(A) applies to debts for money or property that is "obtained by" fraud, it would not ordinarily encompass any liability that the transferor might incur as a result of his participation in a fraudulent-transfer scheme.

In order to pierce Chrysalis's corporate veil under Texas law, however, petitioner was required to establish that the transfers were made "primarily for the direct personal benefit of" respondent himself. Tex. Bus. Orgs. Code Ann. § 21.223(b) (West 2012); see Pet. App. 69a. To make that showing, petitioner sought to demonstrate that respondent diverted Chrysalis's funds to other corporations that respondent controlled. Petitioner's state-law claim thus depends on the allegation that respondent was, as a practical matter, the recipient as well as the transferor of the fraudulently-conveyed funds. If petitioner's evidence is sufficient to establish the requirements for corporate veil-piercing under Section 21.223(b) of the Texas Business Organizations Code Annotated, so that respondent can be held liable under Texas law for Chrysalis's breach of contract, respondent's own debt is properly characterized as one for money "obtained

by * * * actual fraud" within the meaning of 11 U.S.C. 523(a)(2)(A).

In any event, the court of appeals did not find Section 523(a)(2)(A) to be inapplicable here because petitioner's state-law suit was filed against respondent in his capacity as transferor. Rather, the court held that "actual fraud" within the meaning of Section 523(a)(2)(A) requires a false representation. That rationale would apply equally to the more typical case where the debtor who seeks a bankruptcy discharge is solely the recipient of an allegedly fraudulent transfer, and it is erroneous for the reasons set forth above.

B. The Structure And Drafting History Of The Bankruptcy Code's Fraud Provisions Reinforce The Conclusion That The Term "Actual Fraud" Extends Beyond Frauds Involving False Representations

1. The full text of Section 523(a)(2)(A) confirms that the term "actual fraud" is not limited to frauds involving false representations. That provision states that debts for money or property that is obtained by (1) "false pretenses," (2) "a false representation," or (3) "actual fraud" are non-dischargeable in bankruptcy. 11 U.S.C. 523(a)(2)(A). If the phrase "actual fraud" were limited to schemes involving false representations, Congress's addition of that phrase in 1978 would have served no useful purpose, because the Bankruptcy Code specifically precludes discharge of debts for money or property obtained by "a false representation."

2. American bankruptcy law has long barred debtors from discharging debts arising from fraud. Throughout that history, Congress has treated "fraud" and "false representations" as distinct rather than synonymous terms. The court of appeals' con-

struction of Section 523(a)(2)(A) ignores that established practice.

In the Bankruptcy Act of 1867, Congress provided that "no debt created by the fraud or embezzlement of the bankrupt * * * shall be discharged under this act." Act of Mar. 2, 1867, ch. 176, § 33, 14 Stat. 533. In replacing that law with the Bankruptcy Act of 1898, Congress narrowed the range of fraud-related debts that are exempt from discharge to those that had been reduced to "judgments in actions for frauds," and it added a new category of non-dischargeable debts, *viz.* "judgments in actions for * * * obtaining property by false pretenses." Act of July 1, 1898, ch. 541, § 17a(2), 30 Stat. 550 (precluding discharge of debts that "are judgments in actions for frauds, or obtaining property by false pretenses or false representations"). The expansion of the prohibition to cover judgments for obtaining property by false pretenses would have been unnecessary if every judgment for a "fraud[]" is necessarily a judgment for obtaining property by false representation.

Congress's 1903 amendment to the bankruptcy law confirms that Congress viewed the category of debts related to acts of fraud as broader than the category of debts related to obtaining property by false representations. In that amendment, Congress removed the requirement that a non-dischargeable debt be reduced to a judgment, while simultaneously eliminating the explicit prohibition on discharging debts based on fraud (except where the debtor was acting as a fiduciary). Act of Feb. 5, 1903, ch. 487, § 5, 32 Stat. 798 ("A discharge in bankruptcy shall release a bankrupt from all of his provable debts, except such as

* * * are liabilities for obtaining property by false pretenses or false representations").[6]

The explicit reference to "fraud" in the discharge bar did not return to American bankruptcy law until Congress enacted the Bankruptcy Reform Act of 1978 (1978 Act), Pub. L. No. 95-598, 92 Stat. 2549. The 1978 Act replaced former Section 17a(2) with 11 U.S.C. 523(a)(2)(A), which remains in place today with only minor stylistic revisions. 92 Stat. 2590. The new Section 523 harkens back to the Bankruptcy Act of 1898 by separately precluding discharge of debts related to "actual fraud" and debts related to "a false representation." The congressional reports accompanying the enactment explained that, as a result of the changes, "'actual fraud' is added as a ground for exception from discharge." S. Rep. No. 989, 95th Cong., 2d Sess. 78 (1978); accord H.R. Rep. No. 595, 95th Cong., 1st Sess. 364 (1977). That characterization of the amendment's effect confirms what would in any event be the natural inference from the statutory text, *viz.* that "actual fraud" is not synonymous with (or a subset of) "false representation."

3. The court of appeals in this case drew a different inference from the larger statutory context. The court observed that "another provision of the Bankruptcy Code, Section 727(a)(2), excepts from dis-

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[6] At the time, the exclusion of debts related to fraud from the bar on discharge drew criticism from at least one Member of Congress, who argued that the deletion could "permit[] a discharge in bankruptcy where the indebtedness was incurred by fraud." 36 Cong. Rec. 1374-1375 (1903) (statement of Rep. Mann). When a colleague assured him that such debts were covered by the reference to "false pretenses or false representations," the objector responded that "there are many other frauds, of course, besides false pretenses and false representations." *Id.* at 1375.

charge certain fraudulent transfers." Pet. App. 16a. The court stated that "[i]t would appear odd, at the very least, for Congress to have intended that the 'actual fraud' provision cover fraudulent transfers, when there is another provision directly addressing such transfers." *Ibid.* That analysis reflects a misunderstanding of the distinct purposes served by Sections 523(a)(2)(A) and 727(a)(2) within the overall statutory scheme.

Section 727(a)(2) bars a debtor from discharging *any* of his debts if he "has transferred, removed, destroyed, mutilated, or concealed" his property "with intent to hinder, delay, or defraud a creditor" during the one-year period before the bankruptcy petition is filed. 11 U.S.C. 727(a)(2). Even with respect to the fraudulent transferor of property, Section 727(a)(2) provides creditors no protection if more than one year elapses between the fraudulent transfer and the debtor's bankruptcy filing. More importantly for present purposes, Section 727(a)(2) imposes no sanction on a *transferee* who knowingly and intentionally participates in a fraudulent-conveyance scheme and later files for bankruptcy. Section 523(a)(2)(A), by contrast, refers to debts for money or property that is "obtained by * * * actual fraud," language reflecting a particular focus on the debts of the transferee. See pp. 17-18, *supra*. There is nothing anomalous about Congress's enactment of distinct provisions specifying the consequences of a fraudulent-transfer scheme for the maker and recipient of a fraudulent conveyance.[7]

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[7] As discussed above, Section 548(a)(1)(A) permits a bankruptcy trustee to "avoid any transfer * * * of an interest of the debtor in property * * * that was made * * * within 2 years before the date of the filing of the petition, if the debtor voluntarily or invol-

The court of appeals also stated that "other exceptions to discharge in the Bankruptcy Code may be rendered redundant" if Section 523(a)(2)(A) is construed to reach debts arising out of fraudulent-transfer schemes. Pet. App. 16a. The court cited Section 523(a)(4), which excepts from discharge any debt for "fraud or defalcation while acting in a fiduciary capacity," and Section 523(a)(6), which excepts any debt for "willful and malicious injury by the debtor to another entity or to the property of another entity." See *ibid.* But even assuming that one or both of those provisions can be read to encompass fraudulent-transfer schemes, Sections 523(a)(4) and 523(a)(6) clearly cover a wide range of *other* illicit conduct. Neither would be rendered superfluous under petitioner's reading of Section 523(a)(2)(A).[8]

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untary made such transfer * * * with actual intent to hinder, delay, or defraud any entity to which the debtor was * * * indebted." 11 U.S.C. 548(a)(1)(A). Like Section 727, Section 548(a)(1)(A) applies only to transfers made within a limited time before a bankruptcy petition is filed. Also like Section 727, Section 548(a)(1)(A) does not speak to the question whether a transferee who has concealed or dissipated the transferred assets, thereby preventing their return to the bankruptcy estate, can obtain a discharge of his debt if he files his own bankruptcy petition.

[8] Because Section 523(a)(4) applies only to actions taken by a debtor in his capacity as a fiduciary, it would not cover most fraudulent-transfer schemes. It is unclear whether Section 523(a)(6) would apply to debts for money or property obtained through a fraudulent-transfer scheme, and the court of appeals found that provision inapplicable here. Pet. App. 17a-19a. The courts of appeals are divided on the question whether a fraudulent-transfer scheme that has the natural and expected effect of injuring a creditor, but is undertaken for the purpose of benefiting the debtor, effects a "willful and malicious injury" within the meaning of Section 523(a)(6). See, *e.g.*, *In re Jennings*, 670 F.3d

In any event, Section 523(a)(2)(A) refers specifically to debts for money or property "obtained by * * * actual fraud." As explained above, the term "actual fraud" has long been understood to encompass schemes that are intended to cheat creditors by transferring assets beyond their reach. The *possibility* that Section 523(a)(4) or (6) might be construed to bar discharge of debts arising out of fraudulent-transfer schemes provides no sound reason for refusing to give the term "actual fraud" its long-accepted meaning.

C. The Court Of Appeals' Narrow Interpretation Of "Actual Fraud" In Section 523(a)(2)(A) Undermines Congress's Balance Of Competing Policy Objectives In The Bankruptcy Code

In enacting the Bankruptcy Code, Congress sought to serve the sometimes competing interests of giving honest debtors a fresh start and assisting creditors in the recovery of at least some portion of their debts. Section 523(a)'s list of debts that are non-dischargeable reflects Congress's determination that "the creditors' interest in recovering full payment of [those] debts * * * outweigh[s] the debtors' interest in a complete fresh start." *Grogan*, 498 U.S. at 287.

This Court's decisions also reflect "an overriding consideration that equitable principles govern the exercise of bankruptcy jurisdiction." *Kelly* v. *Robinson*, 479 U.S. 36, 49 (1986) (quoting *Bank of Marin* v. *England*, 385 U.S. 99, 103 (1966)). In particular, the Code's "fresh start" policy has much less salience

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1329, 1333 (11th Cir. 2012); *Lawson*, 791 F.3d at 222-224 (1st Cir.); *In re Bammer*, 131 F.3d 788, 792-793 (9th Cir. 1997) (en banc); *In re Saylor*, 108 F.3d 219, 220-221 (9th Cir. 1997). And Section 523(a)(6), unlike Section 523(a)(2)(A), does not apply in Chapter 13 bankruptcies. 11 U.S.C. 1328(a)(2).

when the obligation at issue arises from a debtor's dishonest conduct. See, *e.g.*, *Kelly*, 479 U.S. at 43-53 (finding restitution, as a criminal penalty for welfare fraud, to be non-dischargeable under Section 523(a)(7)); *Grogan*, 498 U.S. at 286-287 (holding that non-dischargeability of particular debts need not be proved by clear and convincing evidence, and explaining that the bankruptcy laws "limit[] the opportunity for a completely unencumbered new beginning to the 'honest but unfortunate debtor'") (quoting *Local Loan Co.* v. *Hunt*, 292 U.S. 234, 244 (1934)); *Brown* v. *Felsen*, 442 U.S. 127, 131-139 (1979) (res judicata did not bar creditor from demonstrating fraudulent conduct under former Section 17(a)(2) in order to prevent discharge of a prior settlement agreement). Construing the term "actual fraud" to encompass the fraudulent-transfer scheme alleged in this case will provide creditors an important protection without burdening the "honest but unfortunate debtor[s]" that the bankruptcy laws are intended to protect.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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APPENDIX

1. 11 U.S.C. 523 provides in pertinent part:

Exceptions to discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

* * * * *

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

(B) use of a statement in writing—

(i) that is materially false;

(ii) respecting the debtor's or an insider's financial condition;

(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and

(iv) that the debtor caused to be made or published with intent to deceive; or

(C)(i) for purposes of subparagraph (A)—

(I) consumer debts owed to a single creditor and aggregating more than $500 for luxury goods or services incurred by an individual debtor on or within 90 days before the order for relief

under this title are presumed to be nondischargeable; and

(II) cash advances aggregating more than $750 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 70 days before the order for relief under this title, are presumed to be nondischargeable; and

(ii) for purposes of this subparagraph—

(I) the terms "consumer", "credit", and "open end credit plan" have the same meanings as in section 103 of the Truth in Lending Act; and

(II) the term "luxury goods or services" does not include goods or services reasonably necessary for the support or maintenance of the debtor or a dependent of the debtor;

* * * * *

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

* * * * *

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity;

* * * * *

2. 11 U.S.C. 548(a)(1) provides:

Fraudulent transfers and obligations

(a)(1) The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

(A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or

(B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(ii)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit

of an insider, under an employment contract and not in the ordinary course of business.

3. 11 U.S.C. 727(a)(2) provides:

Discharge

(a) The court shall grant the debtor a discharge, unless—

* * * * *

(2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed—

(A) property of the debtor, within one year before the date of the filing of the petition; or

(B) property of the estate, after the date of the filing of the petition;

4. Tex. Bus. & Comm. Code Ann. § 24.005(a)(1) (West 2015) provides:

Transfers Fraudulent as to Present and Future Creditors

(a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or within a reasonable time after the transfer was made or the obligation was in-

curred, if the debtor made the transfer or incurred the obligation:

(1) with actual intent to hinder, delay, or defraud any creditor of the debtor; or

5. Tex. Bus. Orgs. Code Ann. § 21.223 (West 2012) provides:

Limitation of Liability for Obligations

(a) A holder of shares, an owner of any beneficial interest in shares, or a subscriber for shares whose subscription has been accepted, or any affiliate of such a holder, owner, or subscriber or of the corporation, may not be held liable to the corporation or its obligees with respect to:

(1) the shares, other than the obligation to pay to the corporation the full amount of consideration, fixed in compliance with Sections 21.157-21.162, for which the shares were or are to be issued;

(2) any contractual obligation of the corporation or any matter relating to or arising from the obligation on the basis that the holder, beneficial owner, subscriber, or affiliate is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory; or

(3) any obligation of the corporation on the basis of the failure of the corporation to observe any corporate formality, including the failure to

(A) comply with this code or the certificate of formation or bylaws of the corporation; or

(B) observe any requirement prescribed by this code or the certificate of formation or bylaws of the corporation for acts to be taken by the corporation or its directors or shareholders.

(b) Subsection (a)(2) does not prevent or limit the liability of a holder, beneficial owner, subscriber, or affiliate if the oblige demonstrates that the holder, beneficial owner, subscriber, or affiliate caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder, beneficial owner, subscriber, or affiliate.

No. 15-145

IN THE

Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC.,
Petitioner,

—v.—

DANIEL LEE RITZ, JR.,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF *AMICI CURIAE* PROFESSORS RICHARD AARON, JAGDEEP S. BHANDARI, SUSAN BLOCK-LIEB, JESSICA GABEL CINO, LINDA E. COCO, BRUCE GROHSGAL, EDWARD JANGER, GEORGE W. KUNEY, C. SCOTT PRYOR, THERESA J. PULLEY RADWAN, MICHAEL D. SOUSA AND LAURA M. SPITZ IN SUPPORT OF RESPONDENT

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January 25, 2016

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INTEREST OF *AMICI CURIAE*[1]

The *amici*[2] are a group of law professors who have devoted their careers to the study and teaching of bankruptcy law. The *amici* represent no institution, group, or association. Their interest is to underscore that the Bankruptcy Code (the "Code") has specific provisions relating to fraudulent transfers, and that whether a debt arising from such a transfer is to be discharged should be determined in light of the text, history, and overall structure of such provisions.

The *amici* are keenly interested in this appeal because the Circuit Courts of Appeals, including the court below, in addressing whether fraudulent transfers are covered by the "actual fraud" provision of section 523(a)(2)(A) of the Code, have mistakenly assumed that the controlling question is whether a false representation is an essential

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[1] Pursuant to Rule 37 of the Rules of this Court, the *amici* file this brief with the written consent of both parties, which are on file with the Clerk. No person or entity including the *amici* or their counsel made a monetary contribution for the preparation or submission of this brief.

[2] The *amici* are the following law professors who teach at the law schools indicated next to their names: Richard Aaron, University of Utah, S.J.Quinney College of Law; Jagdeep S. Bhandari, Wake Forest University School of Law; Susan Block-Lieb, Fordham Law School; Jessica Gabel Cino, Georgia State University College of Law; Linda E. Coco, Barry University School of Law; Bruce Grohsgal, Widener University Delaware Law School; Edward Janger, Brooklyn Law School; George W. Kuney, University of Tennessee College of Law; C. Scott Pryor, Campbell University School of Law; Theresa J. Pulley Radwan, Stetson University College of Law; and Michael D. Sousa, University of Denver Sturm College of Law. *Amicus* Laura M. Spitz devotes full time to her duties as Vice Provost of Cornell University, and thus is not currently a law teacher.

element of that section's "actual fraud" provision. However, the *amici* respectfully submit that such question actually never arises because the discharge of fraudulent transfer debt is *exclusively* controlled by section 727(a) of the Code. Under the specific provisions of section 727(a) regarding fraudulent transfers, such debt is discharged *unless* incurred within one year before the bankruptcy filing. Further, both the plain meaning of that statute and a century of practice show that the "actual fraud" provision of section 523(a)(2)(A) was not enacted to address, much less to except, fraudulent transfer debt from the discharge ultimately received by a chapter 7 debtor. Rather, Congress made a deliberate policy choice that section 727(a) governs the discharge of such debt.

SUMMARY OF ARGUMENT

The *amici* submit that asking whether a misrepresentation is an essential element of an "actual fraud" under section 523(a)(2)(A) disguises Petitioner's false presupposition, namely, that a debt arising from a transfer made to hinder, delay or defraud creditors is capable of being within the scope of section 523(a)(2)(A)'s "actual fraud" provision and thus excepted from a discharge later received by a chapter 7 debtor under section 727(a). That false presupposition leads to an *unnecessary* inquiry whether a misrepresentation is required for a fraudulent transfer to constitute an "actual fraud" under section 523(a)(2)(A). The *amici* would avoid that entire inquiry They submit that the "actual fraud" provision is wholly inapplicable to fraudulent transfer debt. This is because the discharge of a debt arising from a transfer made to hinder, delay, or defraud creditors is exclusively

regulated by sections 727(a) and 727(b), which discharge such debt, unless incurred within one year before the bankruptcy.

Simply stated, Petitioner and its allies attempt to use the "actual fraud" provision of section 523(a)(2)(A) to circumvent a debtor's entitlement to a discharge of fraudulent transfer debt occurring *outside* the statutory one year period. That circumvention is impermissible as a matter of statutory construction, and violates century-old practice and a deliberate congressional policy, for the discharge of such debt.

To begin, there are compelling arguments which make it evident that fraudulent transfer debt is governed exclusively by section 727(a), and is outside the scope of section 523(a)(2)(A).

First, the plain meaning of section 727(a) establishes that only *it* governs the discharge of fraudulent transfer debt, that is, debt arising from transfers to "hinder, delay or defraud" creditors, thereby preventing creditors from reaching the debtor's assets to satisfy their claims.

Second, fraudulent transfer debt, unlike other debts, does not arise from the *particularized* injury incurred by *one* creditor. Rather, fraudulent transfers injure *all* creditors, each of whom is blocked by the transfer from reaching the debtor's property. In light of the central principle of the Code for equality of distribution to similarly situated creditors, section 727(a) should be understood as the sole basis governing the discharge of fraudulent transfer debt. Section 523(a)(2)(A), dealing with injury to a single creditor, does not fit within the Code's structure for the discharge of such debt.

Third, by express Congressional design, section 523(a)(2)(A), *unlike* section 727(a), does not address, or even mention, debts arising from transfers to "hinder, delay, or defraud creditors." It deals with *other* sorts of fraud.

Fourth, to read section 523(a)(2)(A) as in any way applying to fraudulent transfer debts creates an impermissible contradiction with, or redundancy of, section 727(a).

Fifth, the specific provisions of section 727(a) prevail over the general ones of section 523(a)(2)(A).

Sixth, "actual fraud," as used in section 523(a)(2)(A), does not apply to fraudulent transfers because of its threshold requirement that property be *obtained from a* creditor by fraud, which is not met in this case.

Next, most fundamentally, it is a matter of Congressional policy and statutory text, extending for over a century, that fraudulent transfer debts outside the reach-back period of section 727(a)(2) and its predecessors are to be discharged. Petitioner's attempt to bring fraudulent transfers within the scope of section 523(a)(2)(A) based on Congress' codification of *Neal v. Clark*, 95 U.S. 704 (1877) is simply misplaced because *Neal v. Clark* is not a fraudulent transfer case.

Indeed, there is a compelling policy reason why fraudulent transfer debt is governed by section 727(a), which affects the claims of *all* creditors, and cannot be made nondischargeable by a single creditor under section 523(a)(2)(A): fraudulent transfers hide the debtor's assets from *all* creditors, not just from a single creditor. Thus, fraudulent transfer debt that arises within section 727(a)'s one year period results in a denial of

discharge so as to enable *all* creditors to pursue their remedies post bankruptcy, rather than only a single creditor.To allow a single creditor to except its claim alone from the discharge discriminates against the remaining creditors. Of course, that Congress elected the one year period is entirely a matter of its legislative discretion. The precedents of this Court establish that such a Congressional policy choice must be preserved by this Court, even were it to disagree with that policy.

Finally, based on the foregoing, it becomes clear that the principal cases relied on by Petitioner are in error. Those cases fall prey to an erroneous pre-conclusion that fraud of any kind must *always* be punished by denial of discharge. Congress, however, has imposed that consequence only for a fraudulent transfer that occurs within one year before bankruptcy, and if this policy is disagreeable, the solution lies with Congress.

Consequently, the *amici* respectfully ask this Court to uphold the result reached by the Court of Appeals below, namely, that Respondent's debt, if any, for making the transfers in suit cannot be excepted under the "actual fraud" provision of section 523(a)(2)(A) from the discharge he may ultimately receive. However, the reasons advanced by the *amici* to support that result are profoundly different from those employed by the court below.

ARGUMENT

POINT I

DISCHARGE OF DEBT ARISING FROM A FRAUDULENT TRANSFER IS GOVERNED EXCLUSIVELY BY SECTION 727(a)

A. The scope and plain meaning of Code section 727(a)

1. Section 727(a) provides for the discharge of fraudulent transfer debt unless incurred within one year of bankruptcy

Section 727(a), on its face, discharges fraudulent transfer debt incurred more than one year before bankruptcy. Section 727(a)'s introductory clause broadly directs that "[t]the court *shall* grant the debtor a discharge" (emphasis added) and is followed by 12 numbered subsections that specify grounds for denial of the discharge. Clause (2) of section 727(a) denies a discharge if a transfer was made "with intent to hinder, delay or defraud a creditor" of "(A) property of the debtor, within one year before the date of the filing of the petition." This provision in clause (2)(A) for denial of a discharge would not be required if the broad discharge under section 727(a) did not in the first instance discharge all debt. This Court employed like reasoning in *Pennsylvania Dep't of Public Works v. Davenport*, 495 U.S. 552, 562 (1990) ("Had Congress believed that restitution obligations were not 'debts' giving rise to 'claims,' it would have had no reason to except such obligations from discharge in section 523(a)(7)."). See also *Moriyama v. Allen*, 13 F.2d 117, 118 (9th

Cir. 1926) ("By declaring that a fraudulent transfer within the four-month period is a bar to a discharge, Congress by implication declared that a transfer prior to that date will have no such effect.").

Accordingly, section 727(a) facially discharges fraudulent transfer debt where it is incurred beyond the one year reach-back period.

2. Read together, the plain meaning of sections 727(a) and 727(b) demonstrates that section 523(a)(2)(A) does not cover fraudulent transfer debt

The plain meaning of interacting subsections (a) and (b) of section 727 shows that section 523(a)(2)(A) is *not* a basis to except fraudulent transfer debt from a discharge, and Petitioner's reliance on section 727(b) is misplaced. First, section 727(a) expressly provides for granting a discharge to the debtor unless he or she made a fraudulent transfer within one year before the bankruptcy filing. Then, immediately thereafter, section 727(b) states that a discharge discharges all of the debtor's pre-petition debt "[e]xcept as provided in section 523." Clearly, however, Congress did not intend the general section 523 exception provided by section 727(b) to nullify its specific provisions governing the discharge of fraudulent transfer debt under the immediately preceding section 727(a). See *Radlax Gateway Hotel, LLC v. Amalgamated Bank*, 132 S.Ct. 2065, 2071 (2012) ("the specific governs the general"). Accordingly, Congress clearly understood section 523(a)(2)(A) to except from a discharge only debts *other than* fraudulent transfer debts. It would make no sense to read section 523(a)(2)(A) and its inclusion in section 727(b) in any other way.

B. Because section 523(a)(2)(A), unlike sections 548 and 727, does not address debts arising from transfers to "hinder, delay, or defraud" a creditor, it is presumed that Congress acted intentionally to exclude such debt from section 523(a)(2)(A)

Section 727(a) expressly addresses the discharge (or denial of discharge) of debts to "hinder, delay, or defraud" creditors. This identical phrasing is also used in section 548(a)(1)(A) of the Code to provide for the avoidance of fraudulent transfers, and in section 522(o)(4) to reduce the amount of a debtor's exempt property for filing for bankruptcy "with intent to hinder, delay, or defraud a creditor" within 10 years prior to bankruptcy. Congress' use of wholly different language, namely, "actual fraud," in section 523(a)(2)(A) obviously refers to something *other than* fraudulent transfers to hinder, delay, or defraud creditors.

As this Court has stated, "where Congress includes particular language in one section of a statute but omits it in another . . . it is generally presumed that Congress acts intentionally in the disparate . . . exclusion." *Keene Corp. v. United States*, 508 U.S. 200, 208 (1993); accord *Curtis v. United States*, 511 U.S. 485 (2001); *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 538 (1994); *Russello v. United States*, 464 U.S. 16. 23 (1983). The omission of the words "hinder, delay, or defraud" from section 523(a)(2)(A) controls this case because those are words of art used to signify fraudulent transfers and they fail to appear in that provision. Accordingly, section 523(a)(2)(A) should not be read to subvert the discharge provisions of section 727(a) governing transfers to hinder, delay or defraud creditors.

C. Petitioner's reading of section 523(a)(2)(A) renders it either contradictory with, or redundant of, section 727(a)

Petitioner attempts to use the "actual fraud" provision of section 523(a)(2)(A) to defeat a debtor's entitlement to a section 727(a) discharge of fraudulent transfer debt. See *McClellan v. Cantrell*, 217 F.3d 890, 892 (7th Cir. 2000) (hereinafter, "*McClellan*") (explicitly acknowledging the creditor's effort to use section 523(a)(2)(A) to prevent the discharge of a fraudulent transfer debt under section 727(a)); *Cf.*, *amicus* brief filed in this case by the National Association of Bankruptcy Trustees ("NABT") candidly conceding that because the transfers at issue in this case were made more than one year before the bankruptcy filing, a bankruptcy trustee or creditors would be unable to block the discharge of such debt under section 727(a)—because "that relief was not available." See NABT's brief at 11-12. Yet, NABT nevertheless asks this Court to give, through section 523(a)(2)(A), the very relief it acknowledges to be expressly precluded by section 727(a).

Moreover, reading section 523(a)(2)(A) as covering fraudulent transfer debt would make it inconsistent with section 727(a). It would defeat section 727(a)'s provision for discharging such debt incurred prior to the one year period. It is, of course, a fundamental principle that statutes are to be construed consistently and harmoniously with each other. *Food & Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000) (A court must "fit, if possible, all parts [of a statute] into an harmonious whole.").

NABT's only justification for letting section 523(a)(2)(A) contradict section 727(a) is speculation that debtors will defer their bankruptcy filings until at least one year after making fraudulent transfers in order to "block their chapter 7 trustees and creditors from objecting to their general discharge under section 727(a)(2)(A) of the Code." NABT's brief at 4. It is doubtful, however, that debtors who are individuals are sufficiently knowledgeable of the bankruptcy law to make a calculated deferral of a bankruptcy filing, or otherwise able to defer a needed bankruptcy filing for more than a year. In any event, NABT's concern should be addressed by it to the Congress, not this Court.

Alternatively, if Petitioner's reading of section 523(a)(2)(A) does not contradict section 727(a), then that provision becomes superfluous for the following reason. If the debtor makes an intentional fraudulent transfer and the debtor does not ultimately receive a discharge, an order making such debt nondischargeable under section 523(a)(2)(A) as an "actual fraud" will not have been needed because the debt would survive the bankruptcy on its own accord as undischarged debt. But statutes should not be construed so as to be unnecessary or redundant. See *Mackey v. Lanier Collection Agency and Service, Inc.*, 486 U.S. 825, 837 (1988) ("[W]e are hesitant to adopt an interpretation of a Congressional enactment which would render superfluous another portion of the same law.").

Significantly, while the Fifth Circuit Court of Appeals in the present case did not base its holding on section 727(a), that court expressly suggested that fraudulent transfer debt *is* governed by section 727(a), not by section

523(a)(2)(A). In this regard, the Fifth Circuit correctly observed:

> We also note another provision of the Bankruptcy Code, Section 727(a)(2), excepts from discharge certain fraudulent transfers, 11 U.S.C. sec 727(a)(2)(A) ("The court shall grant the debtor a discharge, unless . . . the debtor, with intent to hinder, delay, or defraud a creditor . . . has transferred . . . property of the debtor . .). *It would appear odd, at the very least, for Congress to have intended the "actual fraud" provision cover fraudulent transfers, when there is another provision directly addressing such transfers. See United States v. $92,203.00 in U.S. Currency*, 537 F.3d 504, 509 (5th Cir. 2008) ("We are to read a statute as a whole, so as to give effect to each of its provisions without rendering any language superfluous.")

Id. at 320-21. (emphasis added). The Fifth Circuit, however, went on to rule only on whether a misrepresentation is a required element of an "actual fraud."

Accordingly, section 523(a)(2)(A) is not a vehicle for barring the discharge of fraudulent transfer debt.

D. The specific provisions of section 727(a) prevail over the "actual fraud" general provision in section 523(a)(2)(A)

Petitioner's position that a debt arising from a transfer to hinder, delay, or defraud, specifically described in section 727(a), may be excepted from

a discharge under the general fraud section 523(a)(2)(A), sharply conflicts with the well-established canon of statutory construction that "the specific governs the general." *Radlax Gateway Hotel, LLC*, 132 S.Ct. at 2071 (quoting *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992)). Moreover, this principle would not change even if the general statute were enacted more recently than the specific one. *Radzanower v. Touché Ross & Co.*, 426 U.S. 148, 153 (1976) ("It is a basic principle of statutory construction that a statute dealing with a narrow, precise, and specific subject is not submerged by a later enacted statute covering a more generalized spectrum.").

Applying this canon is particularly appropriate in this case. As is discussed *infra*, Congress' specific provision for the discharge of fraudulent transfer debt reflects its strong policy formulated many years ago and re-enacted thereafter in each of its major modifications of the bankruptcy law. In each instance, Congress made it clear that it intended that the discharge of fraudulent transfer debt be dealt with at the discharge stage of the case, and that the debtor should be freed of such debt unless it was incurred within one year before the bankruptcy filing. As this Court made clear in *Radlax*, it is "particularly true" that "the specific governs the general" where, as here, "Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions," *Radlax*, 132 S.Ct. at 2071, quoting *Varity Corp. v. Howe*, 516 U.S. 489, 519 (1996) (Thomas, J., dissenting).

Thus, even if section 523(a)(2)(A)'s general language could be read as broad enough to cover fraudulent transfer debt, it should nevertheless be

construed as being superseded by the specific provisions of section 727(a). See *D. Ginsberg & Sons, Inc. v. Popkin*, 285 U.S. 204, 208 (1932) (citing *United States v. Chase*, 135 U.S. 255, 260 (1890)) (A "general enactment must be taken to affect only such cases within its general language as are not within the provisions of the particular enactment."). Section 523(a)(2)(A) is just not a vehicle for the nondischarge of fraudulent transfer debt.

E. "Actual Fraud" as used in section 523 does not apply to fraudulent transfers

There is a fundamental difference between fraudulent transfers and other types of fraud: a fraudulent transfer does not use deceit to trick people out of their money, property, or services; rather, it surreptitiously keeps a debtor's assets away from the reach of his or her creditors. A fraudulent transfer is *sui generis*, and must be understood as differing from other frauds. That is why the special sections of the Code that are devoted to fraudulent transfers (sections 548 and 727(a)) do not address other kinds of fraud, and it is also why, correlatively, the special section of the Code devoted to other frauds (section 523(a)(2)(A)) does not address fraudulent transfers.

1. Section 523(a)(2)(A) applies only where property is "obtained" from a creditor

a. The plain meaning of the statute is that property be "obtained" from a creditor

Petitioner candidly acknowledges that section 523(a)(2)(A) applies where a debtor "*received* property" belonging to its creditor. Pet Op Br 50.

(emphasis in original) Moreover, perhaps unwittingly, Petitioner actually concedes that "[s]ection 727(a)(2) applies only where the debtor diminishes the bankruptcy estate by *transferring property away from* the reach of its creditors." *Id.* Effectively, this mirrors the plain text of section 523(a)(2)(A), where the "actual fraud" provision applies only if *something* of the creditor's (money, property, services, or credit) has been "obtained by" the debtor. Because in a fraudulent transfer *nothing* is obtained from the creditor, and only involves a transferor's own property, section 523(a)(2)(A) is inapplicable.

In this case, *nothing* was obtained from the transferor's creditor by means of the transfers made by the debtor. What Petitioner describes as the Respondent's wrongful conduct consists of a classic fraudulent transfer—allegedly draining funds out of a company and transferring them to other entities to place them beyond the reach of a creditor. Nothing of the aggrieved creditor, Husky, was obtained; what was obtained in this case was money of the transferor.[3]

Dictionary definitions reinforce this conclusion. This Court relies on such definitions for the mean-

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[3] Even if section 523(a)(2)(A) applied to a fraudulent transfer debt, such debt could not be excepted under that provision from the discharge the debtor may ultimately receive in this case. This is because the goods purchased from the creditor in this case were not "obtained by . fraud," as required for a debt to be nondischargeable under that provision. As stated by the Fifth Circuit below, purchases of those goods were made over several years pursuant to a written contract, and the Petitioner "had not established that [Respondent] perpetuated an 'actual fraud' on [Petitioner]." *In re Ritz*, 787 F.3d 312, 314.

ing of words. See. *e.g.*, *Baker Botts L.L.P. v. Asarco LLC*, 135 S.Ct. 2158, 2165 (2015); *Bullock v. BankChampaign*, 133 S.Ct. 1754, 1758 (2013). The *English Oxford* dictionary offers the following as the primary definition of the word "obtain": "To come into possession of; to procure; acquire or secure." *Black's Law Dictionary* likewise defines "obtain" as meaning "[t]o bring into one's own possession; to procure." Here, Respondent never 'came into possession' or 'procured' or 'acquired' anything of Husky's.

As aptly stated in *In re Glunk*, 343 B.R. 754 (Bankr. E.D. Penn. 2006), in dismissing a proceeding to except a debt from a discharge for a failure to allege that the debtor obtained anything from his creditor:

> The plain language of the statute unambiguously requires, as a threshold matter, that something of value . . . be transferred to the debtor *from the creditor* to sustain a claim under section 523(a)(2)(A).

Id. at 758, citing *In re Rountree*, 330 B.R. 166, 171 (E.D. Va. 2004) (emphasis added). Accord, *Magten Asset Management Corp. v. Paul, Hastings, Janofsky & Walker, LLP*, 2007 WL 129003 at *2 (D.Del 2007); 4 *Collier on Bankruptcy*, para 523.08[1][a] at p. 523-43. (16th ed.).

Petitioner's contention that the "actual fraud" provision covers fraudulent transfer debt invites this Court to disregard the threshold requirement of section 523(a)(2)(A) that something be "obtained" from the debtor's creditor. This is because Petitioner's lengthy discussion of the common law meaning of actual fraud, Pet Op Br 18-32, like that of its *amici* supporters, does not address the

particular meaning and specific treatment of fraud in the context of the discharge of fraudulent transfer debt under section 727(a) and its numerous predecessors enacted by Congress over more than the last 100 years. Petitioner's presentation boils down to an argument that because a transferor commits a fraud by fraudulently transferring property, such a fraud necessarily falls within the "actual fraud" provision. This conclusory contention, however, is faulty because (among other reasons) it disregards the threshold coverage requirement of section 523(a)(2)(A) that property be "obtained" from the debtor's creditor. Petitioner's argument that "Actual Fraud is Any Intentional Fraud," Pet Op Br 20, utterly fails to be cognizant of section 727(a)'s specific and controlling treatment of fraudulent transfer debt.

b. The historical understanding of fraudulent transfers has always been that they involve transfers of property of the debtor, not obtaining property from a creditor

Historically, fraudulent transfers under the bankruptcy laws have *never* been understood as addressing a debtor wrongfully obtaining property *from* a creditor, which section 523(a)(2)(A) addresses. Rather, they have been understood as transfers involving the *debtor's* own property, designed to hinder, delay, or defraud his or her creditors by placing his or her own property beyond their reach. See *Thomson v. Hanson*, 168 Wash.2d 738, 744 (Wash. *en banc*. 2009) ("In general, a fraudulent transfer occurs where one entity transfers an asset to another entity, with the

effect of placing the asset out of the reach of a creditor with either the intent to delay or hinder the creditor or with the effect of insolvency on the part of the transferring entity."). That, of course, is the situation addressed by section 727(a).

Through the ages, a fraudulent transfer was understood as a transfer of property by a debtor to shield his assets from creditors, not to obtain property from his creditor Fraudulent transfer law originated in English law at least as early as the Statute of Elizabeth over 400 years ago to deal with transfers by a debtor to "hinder, delay, or defraud" creditors so as to place his own property beyond the reach of his creditors. That statute, as understood in the 1601 opinion in *Twyne's* case, 3 Co. Rep. 80a (Star Chamber 1601), was designed to provide a remedy to an unpaid creditor to reach property *of the debtor* that was transferred by the debtor in order to prevent his creditor from collecting a judgment by executing against his property.

Accordingly, section 523(a)(2)(A) is not a basis for excepting a fraudulent transfer debt from the discharge that may ultimately be received by a transferor, a transferee, or other person who may be liable on account of such a transfer.

2. Congress did not intend for transferors and transferees to have different discharge consequences

Congress intended that the test for determining whether a fraudulent transfer debt is to be discharged should be the same for the transferor and the transferee. By its plain text, section 727(a) covers the discharge of all manner of fraudulent transfer debt, whether incurred by the transferor or a transferee who intends to "hinder,

delay, or defraud a creditor." Specifically, a transferee who intentionally "concealed" property that became part of his or her estate upon receiving it from the transferor, is denied a discharge under section 727(a) because of such conduct *only* if such concealment occurred within one year before the bankruptcy.

Moreover, where an intentional fraudulent transfer has been avoided pursuant to section 548(a)(1)(A), the transferee, as the "initial transferee," is obligated by section 550(a)(1) to return the transferred property or its value. A "mediate" (subsequent) transferee incurs a like obligation under section 550(a)(2). A transferee who intentionally participates in a fraudulent transfer thereby incurs a debt that is integral to the fraud. As such, the transferee's debt, like that of the transferor, is covered by the discharge provisions of section 727(a).

Contrariwise, *McClellan,* discussed in depth in Point III *infra,* asserts in conclusory fashion that, just as a transferor's fraudulent transfer creates a "new debt" that differs from his earlier debt to his creditor, the *transferee* likewise incurs a "new debt" as "his accomplice in fraud." However, that court concluded, erroneously, that because the debts of the transferor and transferee based on fraud were *new* debts, they were nondischargeable under section 523(a)(2)(A). *McClellan*, 217 F.3d at 895. *McClellan* got it wrong. These new debts constituted fraudulent transfer debts, and their discharge was governed exclusively by section 727(a) for the reasons offered by this brief. Because they were new debts cannot by means of section 523(a)(2)(A) change their character as fraudulent transfer debts covered by section 727(a) into nondischargeable debts under section 523(a)(2)(A).

Additionally, a transferee is no more culpable in participating in such transfer than is the transferor in making the transfer Because the transferor is discharged under section 727(a) from such debt incurred more than one year before the bankruptcy, Congress could not have intended to deny a discharge to a transferee under the same circumstances even though a transferee is no more culpable than the transferor. Congress would not have provided for the discharge of the transferor's debt and at the same time imposed the harsh consequences of nondischargeability on others for conduct of like quality.

Moreover, the appellate courts that have addressed this issue have generally held that a creditor does not have a cause of action against a person for aiding and abetting the making of a fraudulent transfer. See *Duell v. Brewer*, 92 F.2d 59, 61 (2d Cir. 1937) (per L. Hand, J.) ("Moreover, courts have generally held as to fraudulent conveyances that a person who assists another to procure one, is not liable in tort to the insolvent's creditors."); *Magten Asset Management Corp.*, 2007 WL 129003 at *3. See also *Freeman v. First Union Nat. Bank*, 865 So.2d 1272, 1273 (Fla. Sup. Ct. 2004) (answering a question certified by the 11th Circuit Court of Appeals); *Mack v. Newton*, 737 F.2d 1343, 1357-58 (5th Cir. 1984); *Warne Investments, Ltd. v. Higgins*, 219 Ariz. 186, 196-97 (Ariz. Ct. of Appeals 2008); *Mann v. GTCR Goldner Rauner, L.L.C.*, 483 F.Supp. 2d 884, 918 (D.Ariz. 2007). Moreover, even if the Court were to reject the prevailing rule that a person does not incur liability for aiding and abetting a fraudulent transfer, the debt resulting from such action

would nevertheless be discharged under section 727(a) because, as here, it arose more than one year before the bankruptcy.

Accordingly, the discharge of debt of a transferor, a transferee and of any other person sustaining liability for a role in a fraudulent transfer, is governed exclusively by section 727(a).

POINT II

IT IS ESTABLISHED CONGRESSIONAL POLICY TO DISCHARGE FRAUDULENT TRANSFER DEBTS OUTSIDE THE ONE YEAR REACH-BACK PERIOD OF SECTION 727(a)

A. The discharge provisions of section 727(a) represent a long-standing policy choice by Congress

The discharge of fraudulent transfer debt was not new to the 1978 Code. Section 727(a) reflects a policy choice made by Congress over 100 years ago, and repeatedly reaffirmed since then. The predecessor of section 727(a), enacted in 1903 as section 14b(4) of the Bankruptcy Act of 1898, provided for the discharge of fraudulent transfer debt that arose prior to a four month reach-back period. See Bankruptcy Act of 1898, Pub. L. No. 62, section 14b, 30 Stat. 550 (amended 1903) (A discharge shall be granted unless the debtor "(4) at any time subsequent to the first day of the four months immediately preceding the filing of the petition transferred . . . any of his property with intent to hinder, delay, or defraud his creditors."). See *Moriyama*, 13 F.2d at 118 (applying former section 14b(4)'s four month reach-back provision).

Prior to the 1903 amendment, the Bankruptcy Act of 1898 had no provision requiring the denial of a discharge because of the debtor's incurrence of fraudulent transfer debt, and section 14b of the 1898 Act enabled the debtor to obtain a discharge of all debt, unless the debtor, during the bankruptcy, concealed property of the estate from the trustee, or fraudulently concealed his true financial condition from the trustee. The 1898 Act, moreover, limited the exception from a discharge based on fraud to those cases in which a *judgment* was already issued against the debtor on a cause of action based on fraud.

The liberal provisions of the 1898 Act, enabling the debtor easily to obtain a discharge from debts incurred by reason of fraud, led to a widespread reaction in the creditor community calling for Congress to amend the bankruptcy discharge provision. Some creditors asserted that the bankruptcy law went too far helping debtors, and that the ease with which debtors obtained broad discharges encouraged commercial dishonesty. See Charles Jordan Tabb, *The Historical Evolution of the Bankruptcy Discharge,* 65 Am. Bankr. L. J. 325, 366 (1991) (summarizing the criticism of the original section 14b discharge provision of the 1898 Act). Congress responded five years later by the enactment in 1903 of amendments to the 1898 Bankruptcy Act, which included new section 14b(4) providing for a four month reach-back period. Congress' purpose in enacting the 1903 amendment was to "stamp out" such abuse of the bankruptcy system; its 1902 bankruptcy bill would have refused a discharge for "making a fraudulent transfer of property." See 35 Cong. Rec. H6940 (June 17, 1902). Congress, however, in its

judgment, did not view as abusive the discharge of fraudulent transfer debts incurred more than four months before bankruptcy.

After enacting the 1903 provisions for discharge of fraudulent transfer debts, Congress addressed such debts in 1926 by lengthening the reach-back period under section 14b(4) to one year. See 67 Cong. Rec. H7677 (April 17, 1926). Thereafter, Congress chose to carry forward the substance of section 14b(4) into the bankruptcy law it enacted in 1938. Subsequently, the Congressionally authorized July 1973 Report of the Commission on the Bankruptcy Laws of the United States provided for continuing in effect the substance of section 14b(4). See Commission Report, 93rd Cong., 1st Sess., H. Doc. No. 93-137, Part II, page 132, lines 2-7. Congress deferred to the 1973 Commission Report by carrying the one year reach-back provision into the present Code in 1978 as section 727(a)(2)(A). See H. Rep. 95-595 at 384 (1977) and S.Rep. 95-989 at 98 (1978).[4]

When Congress wrote the one year reach-back provision into section 727(a)(2)(A) of the present Code, it did not write on a clean slate. As noted by this Court in *Emil v. Hanley,* 318 U.S. 515, 521 (1948), "[W]hen Congress wrote [a] four months proviso [into the then current Bankruptcy Act of 1938] it was not writing on a clean slate." Prior history of a statute guides our understanding of Congressional enactments. That Congress

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[4] The Congressional history does not provide an explicit explanation for the length of the reach-back period chosen by Congress, but none is needed because Congress has "great latitude" to make such choice in exercising its constitutional powers. *National Federation of Independent Business v. Sebelius*, 132 S.Ct. 2566, 2579 (2012).

legislates in the context of the history is especially relevant in bankruptcy where numerous prior statutes had been in effect when the Code was passed in 1978. This Court has recognized that, except to the extent explicitly changed under the Code, Congress intended the pre-Code law to remain in effect. *BFP*, 511 U.S. at 544-45; *Bank of America, N.A. v. Caulkett*, 135 S.Ct. 1995, 2000 (2015) (reaffirming *Dewsnup v. Timm*, 502 U.S. 410, 419-20 (1992).).

Section 727(a) thus represents a clear continuation of a policy choice made by Congress over 100 years ago. Significantly, ever since its enactment of the Code in 1978, Congress has not changed its treatment of fraudulent transfer debt, although it had the opportunity to do so at each of the several times after 1978 when it amended the Code. See 6 *Collier on Bankruptcy* para 727.LH[1], p. 727-82 (16th ed. 2014). In light of the history of this provision, it would be odd to attribute to Congress an intent that section 523(a)(2)(A)'s "actual fraud" provision would be a basis to except from a debtor's discharge a fraudulent transfer debt that it intended would be discharged under section 727(a).

B. The Congressional policy regarding the discharge of fraudulent transfer debt makes sense because section 727(a) implements the central policy of equality of distribution to all creditors

Although this Court's precedents require deference to the policy choices of Congress, it is always reassuring when a plausible reason can be given for a policy choice. Such a reason exists here: equality of treatment of creditors, which this

Court recognizes as a central bankruptcy policy. *Begier v. I.R.S.*, 496 U.S. 53, 58 (1990) ("Equality of distribution among creditors is a central policy of the Bankruptcy Code."); *Union Bank v. Wolas*, 502 U.S. 151, 161 (1991) (recognizing that equality of distribution is a prime bankruptcy policy). Fraudulent transfers diminish the bankruptcy estate generally. By making a fraudulent transfer within the one year reach-back period grounds for denial of discharge it permits *all* creditors, each of whom is equally injured by the transfer, to benefit equally. This is because all creditors are free to pursue recovery of their debts if the transfer occurred within one year before the bankruptcy. In contrast, denial of dischargeability benefits only one creditor, thereby violating the Code's central policy of equality of distribution.

The Code itself, in section 548(a)(1)(A), makes clear that, by authorizing the *trustee* as the one to avoid a fraudulent transfer, for the benefit of *all* creditors, Congress would not have intended to allow *one* creditor, by means of section 523(a)(2)(A), to gain an advantage over all of the other creditors through excluding only his own claim from the debtor's discharge. Moreover, if one creditor were allowed so to use section 523(a)(2)(A), then every creditor could bring a proceeding under that provision, which would result in unnecessary duplicative litigation over the same issue, *i.e.*, whether the debtor made a fraudulent transfer of his property, rather than by decision in a single proceeding under section 727(a) governing the discharge of debt.

Because a fraudulent transfer impairs the collective rights of the creditors, fraudulent transfer debt is addressed exclusively by section

727(a). Under that provision, all creditors, not just one, would have the right after the bankruptcy to pursue collection on an equal footing of their fraudulent transfer claims that arose within one year before the bankruptcy. Using section 523(a)(2)(A) to except from the discharge a particular fraudulent transfer debt, however long ago it was incurred, simply does not fit within the structure of the Code regarding the discharge of such debt. The discharge of such debt is governed exclusively by section 727(a).

C. Congress' policy determination must be respected

In *Moriyama*, 13 F.2d at 117, a creditor objected to the grant of a discharge because the debtor had fraudulently encumbered his property by mortgaging it. In reversing the judgment below and directing the lower court to grant a discharge because the mortgages in question were made before the beginning of the four month reach-back period then in effect, the court stated:

> It would be sufficient, under that subdivision, if it appeared that the mortgages were executed at a time subsequent to the first date of the four months immediately preceding the filing of the petition; but the petition contains no such allegation, whereas the evidence shows without contradiction that the mortgages were in fact executed long prior to the beginning of the four-month period. *By declaring that a fraudulent transfer within the four-month period is a bar to a discharge, Congress by implication declared that a transfer prior to that date will have no*

> *such effect.* The objecting creditor seems to contend that a discharge may be denied *on moral or ethical grounds*, regardless of the statute; but this contention is wholly unfounded.

Id. (emphasis added).

In *In re Wakefield*, 207 Fed. 180 (N.D.N.Y. 1913), the court likewise discharged a debtor's fraudulent transfer debt where incurred more than four months prior to the bankruptcy, despite the judge's disagreement with Congress' discharge policy:

> Personally I would remove the limitation to the four months preceding the filing of the petition; but the courts do not legislate, and here there is no opening for a construction of the language.

Id. at 183.

Indeed, Congress' policy for the discharge of all but recently incurred fraudulent transfer debt is so strong that it did not limit it to chapter 7. In addition to chapter 7, when enacting the Code in 1978 Congress also made section 727(a)'s provision for discharging such debt applicable to an individual debtor in chapter 11 by means of section 1141(d)(3)(C) of the Code.

This Court holds that where a statute is clear, a court must enforce it as written, even though it may disagree with the policy choice made by Congress. As succinctly stated by this Court in *Florida Dept. of Revenue v. Piccadilly*, 128 S.Ct. 2326, 2338 (2008), "it is not for us to substitute our view . . . of policy for the legislation which has been passed by Congress." (quoting *United Parcel*

Service v. U.S. Postal Service, 604 F.3d 1370, 1381 n. 16 (2010) ("Our function as jurists is to require compliance with those statutes enacted by Congress. In this case it is not for us to substitute our view of postal policy for the legislation which has been passed by Congress.")

More recently, this Court expressed the same notion in *National Federation of Independent Business v. Sebelius*, 132 S.Ct. at 2569 ("Members of this Court . . . possess neither the expertise nor the prerogative to make policy decisions. Those decisions are entrusted to our Nation's leaders."). See also Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Col. L. Rev. 527,553 (1947) ("Whatever temptations the statesmanship of policy-making might wisely suggest, construction must eschew interpolation and evisceration."). Moreover, in a bankruptcy case decided scarcely a few months ago, this Court underscored its declination to depart from statutory text, stating: "But these lines were set by Congress, not this Court."). See *Bank of America, N.A. v. Caulkett*, 135 S.Ct. at 1999.

This rationale is rooted in the enumerated power of Congress to make all Laws, as conferred by Article I, section 8 of the Constitution. *Sebelius*, 132 S.Ct. at 2579. This Court has long read this Article of the Constitution to give Congress great latitude in excising its power, and has recognized that Congress is in the best position to make policy judgments. This is particularly so in bankruptcy cases in light of Congress' specific power under Article I, section 8, clause 4 of the Constitution to enact bankruptcy laws. Congress' judgment regarding the discharge of fraudulent transfer debt should thus be respected.

As this Court aptly stated in a similar context where it affirmed respect for a controversial Congressional bankruptcy policy judgment:

> Certainly, there may be compelling policy reasons for treating postpetition income tax liabilities as nondischargeable. But if Congress intended that result, it did not so provide in the statute. Given the statute's plain language, context, and structure, it is not for us to rewrite the statute particularly in this complex terrain of interconnected provisions and exceptions enacted over nearly three decades.

Hall v. United States, 132 S.Ct. 1882, 1893 (2012). This Court has left no doubt as to its respect for Congressional policy underpinning legislation. See *Piccadilly*, 128 S.Ct. at 2338; *Sebelius*, 132 S.Ct. at 2569.

This Court should respect the policy judgment made by Congress regarding the discharge of fraudulent transfer debt.

This Court left no doubt in *Law v. Siegel*, 134 S.Ct. 1188 (2014) that the Code must be applied according to its plain text, not "based on whatever considerations [the courts] deem appropriate." 134 S. Ct. at 1196. In that case, the debtor fabricated a loan and falsified a mortgage in order to increase the amount of his homestead exemption under section 522. Despite the debtor's egregious misconduct, this Court held that the bankruptcy courts lacked statutory authority to surcharge the debtor's exempt property for the legal costs incurred as a consequence.

This Court explained:

> We acknowledge that our ruling forces Siegel to shoulder a heavy financial burden resulting from Law's egregious misconduct, and that it may produce inequitable results for trustees and creditors in other cases. . . . For the reasons we have explained, it is not for courts to alter the balance struck by the statute. [citations omitted].

Id. at 1197-98. Likewise, in deciding whether fraudulent transfer debt would be discharged or survive bankruptcy, Congress made the choice that such a debt would survive only if it was incurred within one year before bankruptcy. Its choice is entitled to deference.

D. *Neal v. Clark* did not involve a fraudulent transfer of property, and by codifying the rule in *Neal v. Clark* when enacting section 523(a)(2)(A), Congress did not intend to allow fraudulent transfer debt to be excepted from a debtor's discharge

Contrary to Petitioner's contention, the codification of *Neal v. Clark* by Congress in enacting section 523(a)(2)(A) was not intended by it to bring fraudulent transfers within its "actual fraud" provision. A careful reading of *Neal v. Clark*, and of the Congressional history of that provision, demonstrates that the view held by Petitioner, and of the two Circuit Courts of Appeals on which it relies, is wrong.

When enacting section 523(a)(2)(A), Congress stated that it intended to codify the rule in *Neal v.*

Clark, 95 U.S. 704 (1877). See 124 Cong. Rec. H 32,392, 33,399 (Daily ed. Sept. 28, 1978). Representative Edwards, as floor manager of the 1978 bankruptcy legislation, there explained that "Subparagraph (A) [of proposed section 523(a)(2)] is intended to codify current case law, *e.g.*, *Neal v. Clark*, 95 U.S. 704 (1877), which interprets 'fraud' to mean actual or positive fraud rather than fraud implied in law " See 124 Cong. Rec. H11,095-11,096 (Daily ed. Sept. 28, 1978); 124 Cong. Rec. S17, 412-13 (Daily ed. Oct. 6, 1978) ("Subparagraph A [of section 523(a)(2)(A)] is intended to codify current case law which interprets fraud to mean actual or positive fraud rather than fraud implied in law.").

The *amici* submit that in codifying *Neal v. Clark* Congress did *not* bring fraudulent transfer debt within the "actual fraud" provision of section 523(a)(2)(A). This is because *Neal v. Clark* did *not* involve or even mention fraudulent transfer debt. Congress codified *Neal v. Clark* to evidence its intent that in cases to which section 523(a)(2)(A) *would* apply—to wit, cases *other* than those involving fraudulent transfers—positive fraud, not constructive fraud, had to be established.

Neal v. Clark involved the sale of property of a decedent's estate by its executor. The executor sold securities of the estate to a purchaser at a discounted price. It later appeared that the executor used the proceeds for his own personal purposes and was financially unable to make the estate whole for its loss. The executor's conduct was culpable, but not a fraudulent transfer to keep property beyond the reach of creditors. A successor executor tried to recover for the loss

from the purchaser, who then filed in bankruptcy. In that bankruptcy, the successor executor asserted that the debtor-purchaser should be held liable for the loss sustained by the decedent's estate. In holding for the debtor-purchaser, this Court concluded that the debtor-purchaser "was not chargeable with actual fraud, but in view of the circumstances attending the purchase, he had committed constructive fraud, which implicated him in the *devastavit*." *Neal v. Clark*, 95 U.S. at 707. Because *Neal v. Clark* did not involve a fraudulent transfer of a debtor's property to keep it beyond the reach of his creditors, the codification of *Neal v. Clark* cannot be understood as indicating Congressional intent to bring fraudulent transfer debt within the "actual fraud" provision of section 523(a)(2)(A).

Section 523(a)(2)(A) was enacted to provide for excepting from discharge debts for fraud *other than* those arising from fraudulent transfers. Whatever the scope of "actual fraud" under section 523(a)(2)(A) may be, it is clear that that provision was not enacted to except from a debtor's discharge fraudulent transfer debt incurred more than one year before his or her bankruptcy.

Accordingly, it is evident that when Congress approved the rule of *Neal v. Clark* when enacting section 523(a)(2)(A), Congress' *only* purpose was to make clear that, in a case involving a fraud of the type that *is* covered by section 523(a)(2)(A), a finding that the debtor committed an "actual fraud" must be based on positive fraud by the debtor, not on constructive fraud implied in law.

POINT III

THE *McCLELLAN* AND *LAWSON* CASES WERE WRONGLY DECIDED

Each of the Circuit Courts of Appeals that addressed the discharge of fraudulent transfer debt concluded, erroneously, as does Petitioner and its *amici* supporters, that an intentional fraudulent transfer falls within the "actual fraud" provision of section 523(a)(2)(A). In doing so, they failed to recognize that the discharge of such debt is governed exclusively by section 727(a). The leading decision that so erred is *McClellan*, 217 F.3d 890, which is the principal authority on which Petitioner relies.

In *McClellan*, the debtor's brother purchased machinery to be paid for in installments. After the brother defaulted and the seller commenced a collection suit to recover the unpaid sales price, the brother made a gratuitous "sale" for $10 of his own property to his sister, who resold it for a substantial amount. Two years later the sister commenced a chapter 7 bankruptcy case. The creditor brought a proceeding in the bankruptcy court to collect the unpaid price from the debtor-sister on the theory that the transfer to her was an intentional fraudulent transfer. The bankruptcy court dismissed the action on the ground that the debt was dischargeable, and the district court affirmed on the ground that a debt could not be excepted from a discharge as an "actual fraud" under section 523(a)(2)(A) absent a material misrepresentation, relying on *Field v. Mans*, 516 U.S. 59, 68 (1995). *McClellan*, 217 F.3d at 892.

In reversing, the Court of Appeals in *McClellan* held, erroneously, that a debt arising from a transfer made in a deliberate attempt to thwart the creditor's collection effort is excepted from the debtor's discharge as an "actual fraud" within section 523(a)(2)(A). According to that court's misunderstanding of the Code, a fraudulent transfer debt should be treated *the same* as all other debt, and thus may be excepted from a discharge as an "actual fraud" under section 523(a)(2)(A). Moreover, that court's "new debt" theory cannot change a fraudulent transfer debt, from which the debtor is entitled to be discharged under section 727(a), into a nondischargeable debt by means of section 523(a)(2)(A). See Point I.E.2 *supra*. That court, however, in its quest to prevent the debtor from using bankruptcy to discharge a debt for fraud, failed to comprehend that section 727(a), like its several predecessors, accorded *special* treatment to fraudulent transfer debt, by which such debt is discharged unless incurred within one year before bankruptcy. As the court stated in *McClellan*:

> Pressed at argument, [the debtor's] lawyer was unable to suggest any reason why the type of fraud presented by the allegations of McClellan's complaint should be treated differently from other types of fraud. The two-step routine that McClellan alleges and that we must take as true—in which debtor A transfers valuable property to B for nothing in order to keep it out of the hands of A's creditor and B then sells the property and declares bankruptcy in an effort to shield herself from liability for having colluded with A to defeat the rights of A's creditor—*is as blatant an*

> *abuse of the Bankruptcy Code as we can imagine. It turns bankruptcy into an engine for fraud.*

Id. at 893. (emphasis added).

It is understandable that a court may wish not to allow a person who committed a fraud ever to be freed by bankruptcy from the resulting debt. However, that is not what Congress wrote in section 727(a). If the fraudulent transfer is made within one year before bankruptcy, discharge is denied, which is no small consequence; otherwise, the debt is discharged. As shown above, what Congress actually wrote is to be accorded deference and its policy upheld, even if the court were to disagree with that policy. *McClellan's* fundamental error was to deny a discharge of fraudulent transfer debt *on moral and ethical grounds*, in disregard of clear Congressional policy expressed in statutory text. As stated in *Moriyama*:

> The objecting creditor seems to contend that discharge may be denied on moral and ethical grounds; regardless of the statute; *but this contention is wholly unfounded.*

13 F.2d at 118 (emphasis added).

To the *McClellan* court, the notion that fraud cannot be discharged in bankruptcy under any circumstances was so strong that, in its view, "[n]o learned inquiry into the history of fraud is required. . . ." *McClellan*, 217 F.3d at 893. That court's *a priori* zeal in *McClellan* to draw fraudulent transfer debt into section 523(a)(2)(A) may well have inhibited its own inquiry into the history, provisions, and structure of the discharge provisions of the Code. Having failed to focus on the

discharge provisions of the Code, that court erred in assuming that fraudulent transfer debt is covered as an "actual fraud" under section 523(a)(2)(A). *McClellan* was simply wrongly decided.

The Petitioner also relies heavily on *In re Lawson*, 791 F.3d 214 (1st Cir. 2015), cert. pending *sub nom. Sauer v. Lawson*, Docket No. 15-113. The fraudulent transfer debt in *Lawson*, as in *McClellan*, arose more than one year before the bankruptcy. Nevertheless, the court in *Lawson*, relying heavily on *McClellan*, likewise erroneously held that "knowingly accepting a fraudulent conveyance that the transferee knew was intended to hinder the transferor's creditors" may be excepted from the debtor's discharge under the "actual fraud" provision of section 523(a)(2)(A). In so holding, the Circuit Court in *Lawson* disapproved the bankruptcy court's reading of the *Lawson* Court's earlier decision in *Palmacci v. Umpierrez*, 121 F.3d 781 (1st Cir. 1997) as requiring a misrepresentation as an element of an "actual fraud." Significantly, however, *Lawson* failed to take note of the *specific* mention of *section 727(a)(2)* in the court's own decision in *Palmacci*, 121 F.3d at 786. Like *McClellan*, the court in *Larson* simply failed to comprehend that fraudulent transfer debt is governed by, and discharged under, section 727(a).

CONCLUSION

The discharge provisions in section 727(a) of the Code reflect an explicit legislative judgment. This judgment, made by Congress through the democratic process, in turn reflects the circumstances in which a debtor who is an individual should be placed upon emerging from bankruptcy,

namely unburdened by fraudulent transfer debt incurred more than one year before filing for bankruptcy relief.

Based on the foregoing, the order appealed from should be affirmed because the transfers in suit cannot be excepted under the "actual fraud" provision of section 523(a)(2)(A) from the discharge the Respondent may ultimately receive.

Respectfully submitted,

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In the Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC.,

Petitioner,

v

DANIEL LEE RITZ, JR.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF BANKRUPTCY LAW PROFESSORS AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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INTEREST OF *AMICI CURIAE*[1]

Amici curiae are professors who teach, study and write about bankruptcy law. Through their scholarship, *amici* have focused on the text, structure, history, and policy underpinnings of the Bankruptcy Code; the application of bankruptcy law by courts nationwide; and the practical economic impact of the bankruptcy system on the people and institutions of the United States. Accordingly, *amici* have a deep interest in the correct interpretation of the Bankruptcy Code and the correct implementation of the important public policies on which bankruptcy law is based.

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[1] Letters of consent have been filed with the Clerk. Pursuant to Supreme Court Rule 37.6, *amici curiae* state that no counsel for a party has authored this brief in whole or in part, and no person or entity, other than the *amici curiae* or their counsel, made a monetary contribution to the preparation or submission of this brief.

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Amici take no position on the underlying dispute between the parties: whether respondent is entitled to discharge a debt to the petitioner in the particular circumstances of this case. *Amici* submit this brief to address the Fifth Circuit's narrow reading of the statutory words "actual fraud" in Bankruptcy Code Section 523(a)(2)(A). Contrary to the holding of the Fifth Circuit, those statutory words are not limited only to circumstances in which a debtor made false representations to a creditor. Such a restrictive reading of § 523(a)(2)(A), would reward the dishonest — especially the more ingeniously dishonest — at the expense of the victims they intended to defraud. The Fifth Circuit's reading would, moreover, upset the Bankruptcy Code's balance between affording a fresh start to honest but unfortunate debtors and policing against fraudulent conduct by debtors.

SUMMARY OF ARGUMENT

The term "actual fraud" as a basis for denying the discharge of a debt in bankruptcy is not confined to a static definition that requires, in every instance, a false representation by the debtor to the creditor. Consistent with more than a century of judicial explanation, the inclusion of "actual fraud" in Bankruptcy Code § 523(a)(2)(A) as one of three bases for excepting a debt from the scope of a discharge afforded debtors in bankruptcy applies to more than just misrepresentations.

The narrow conception of "actual fraud" upon which the decision below is based is both historically inaccurate and inherently unsound. It is historically inaccurate because for almost 140 years this Court and Congress have employed a different standard. As early as *Neal v. Clark*, 95 U.S. 704 (1877), this Court equated "actual fraud" with intentional "positive fraud" and distinguished that conduct from "constructive fraud." Debt arising from the former has long been nondischargeable, while debt arising from the latter can be discharged. Neither category has ever been viewed as requiring a representation of any sort in the context of a dischargeability challenge. That distinction has remained a guiding principle of this Court's jurisprudence. Most important with respect to the correct disposition of this case, that distinction was expressly invoked as a guiding principle for the 1978 enactment of the Bankruptcy Code. Even outside the context of dischargeability challenges, the decision below is

also historically inaccurate because it misperceives the state of the common law in 1978, as well as the state of the common law today.

The Fifth Circuit's definition of "actual fraud" is inherently unsound because it would create a "how-to" manual for intentional wrongdoers to be rewarded for their deception. A potential wrongdoer can use the Code's discharge provisions as shelter — evading liability for intentional wrongdoing — simply by structuring the fraud to avoid making a false representation to a creditor. The Fifth Circuit's definition of "actual fraud," therefore, rewards dishonest conduct in a way not contemplated by the text or legislative history of the Bankruptcy Code. As some modern Ponzi schemes illustrate, technology enables the commission of fraud on a massive scale, in remote ways, using hard-to-detect devices. For these reasons, the Fifth Circuit's requirement of a false representation by the debtor to the creditor is bad economic and social policy. Bad economic policy because it hinders the victims of intentional wrongdoers from being made whole. Bad social policy because it rewards intentionally fraudulent behavior that attacks the integrity of the bankruptcy system. In short, the decision below would upset the Bankruptcy Code's careful balance between (a) providing a fresh start for honest-but-unfortunate debtors and (b) preventing the fresh start from "giving the perpetrators of fraud a fresh start over the interest in protecting the victims of fraud." *Cohen v.*

de la Cruz, 523 U.S. 213, 223 (1998) (*quoting Grogan v. Garner*, 498 U.S. 279, 287 (1991)).

ARGUMENT

SECTION 523(a)(2)(A) PRECLUDES A DISCHARGE IN BANKRUPTCY FOR ANY DEBT OBTAINED BY A DEBTOR'S ACTUAL FRAUD

Section 523(a)(2)(A) of the Bankruptcy Code excepts "any debt ... for money, property, services, or an extension, renewal or refinancing of credit, to the extent obtained by ... false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." 11 U.S.C. § 523(a)(2)(A). If, as the Fifth Circuit held, "actual fraud" cannot be established where "the debtor made no false representation to the creditor" (Pet. App. 6a-7a), then the statutory category of "actual fraud" is wholly redundant. Since petitioner's merits brief explains the multiple ways in which the Fifth Circuit's holding runs counter to this Court's longstanding canons of statutory construction, *amici* will not replow that ground here.

A simple schematic illustration should suffice: Under the Fifth Circuit's view, a party opposing a discharge must prove **A** ***or*** **A+B.** If the party opposing discharge fails to prove **A**, then it necessarily loses under both category **A** and category **A+B.** And if the party opposing discharge

successfully proves **A**, then it has prevailed under category **A** and neither it nor the court has any reason to address category **A+B.** Accordingly, under the decision below, **B** drops out of the statute altogether and category **A+B** plays no role in any potential scenario. That is not how legislatures draft statutes. That is not how courts interpret statutes.

By asking whether "actual fraud" is entirely subsumed by the "false representation" category, the Fifth Circuit embarked on the wrong inquiry, which led it to the wrong result. As *amici* will explain, the correct inquiry should take the statute as written, and then focus on the separate meaning and substance of each category in § 523(a)(2)(A).

Rigorous analysis should also be informed by this Court's historic understanding that "[t]he Bankruptcy Code has long prohibited debtors from discharging liabilities incurred on account of their fraud, embodying a basic policy animating the Code of affording relief only to an honest but unfortunate debtor." *Cohen v. de la Cruz*, 523 U.S. 213, 217 (1998). Consistent with that stated policy, the fraud exception from discharge is not limited to fraud perpetrated through the use of a misrepresentation; rather, the statutory exception from discharge covers a broad array of deceitful conduct and intentional wrongs, specifically including fraudulent-transfer schemes intended to harm a creditor.

1. The Bankruptcy Code, its antecedents and legislative history make clear that "actual fraud" means intentional wrong, and is not dependent on a debtor making a misrepresentation to a creditor.

The Bankruptcy Code's exception for discharge of debts obtained by actual fraud originated in Section 33 of the Bankruptcy Act of 1867, which provided that "no debt created by the fraud or embezzlement of the bankrupt or by defalcation as a public officer, or while acting in a fiduciary capacity, shall be discharged under this act .." Bankruptcy Act of 1867, 14 Stat. 5117. Section 33 of the 1867 Bankruptcy Act was "substantially a re-enactment of the act of 1841" except for the addition of the phrase not appearing in the 1841 Act that "no debt created by fraud . ." was dischargeable. *Noble v. Hammond*, 129 U.S. 65, 69 (1889).

The 1867 Act did not expressly define the newly-added term "fraud." In *Neal v. Clark*, 95 U.S. 704 (1877), this Court first articulated the type of fraud that justified denial of discharge under Section 33 of the 1867 Act. As Justice Harlan's opinion for the Court explained, the controversy in *Neal* arose from a constructive fraudulent transfer, which the lower courts found to be sufficient to justify exclusion of the underlying debt from the bankruptcy discharge.

The central point — and the one most pertinent to defining "actual fraud" in the current statute —

was the distinction the Court drew in *Neal* between constructively fraudulent transfers (which were insufficient to exclude a debt from discharge under the 1867 Act), and intentionally fraudulent transfers (for which debt discharge would be denied):

> [D]ebts created by 'fraud' are associated directly with debts created by 'embezzlement.' Such association justifies, if it does not imperatively require, the conclusion that the 'fraud' referred to in that section means positive fraud, or fraud in fact, involving moral turpitude or intentional wrong, as does embezzlement; and not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality.

Neal v. Clark, 95 U.S. 704 at 709.

The term "fraud" included "positive fraud" such as fraud in fact and was not limited to misrepresentation. And "actual fraud" sufficient to deny discharge under the 1867 Act was to be found in any conduct involving moral turpitude or intentional wrong.

This Court continued to apply the *Neal v. Clark* definition of fraud throughout the Nineteenth Century. Repeatedly, the Court distinguished acts of actual fraud, involving bad faith, moral turpitude, or wrongful intent, from conduct that was merely

constructively fraudulent. *See Strang v. Bradner*, 114 U.S. 555, 559 (1885); *Hennequin v. Clew*, 111 U.S. 676 (1884); *Palmer v. Hussey*, 119 U.S. 96 (1886).

2. The rule set forth in *Neal v. Clark*, distinguishing between intentional fraud and constructive fraud in dischargeability cases was carried forward in the Bankruptcy Act of 1898.

As initially enacted, the 1898 Act prohibited discharge of "judgments in actions for fraud, or obtaining property by false pretenses or false representations," § 17(a)(2), 30 Stat. 550. Five years later, Congress amended §17(a)(2) to eliminate the requirement that the debt be reduced to "judgment" and also deleted the word "fraud." § 17(a)(2), 32 Stat. 798. The House Report explained:

> [The amendment to Section 17(a)(2) of the Bankruptcy Act] provides that liabilities for frauds, etc., as described in the act shall not be released by the discharge. As the law now is these liabilities must have been reduced to judgment or else the bankruptcy is discharged. This amendment is in the interest of justice and honest dealing and honest conduct. H. Rpt. No. 1698, 57th Congress, 1st Sess., 3 (1902).

> The changes in section 17 of the law are to settle questions arising from the antagonistic decisions of the court and to exclude beyond peradventure certain liabilities growing out of offenses against good morals from the effect of a discharge. *Id.* at 6.
>
> . . .
>
> The substitution of "liabilities" for "judgments in actions" makes the clause broader. Now claims created by fraud but not reduced to judgment are discharged. Neither the claim nor the judgment should be. [citations omitted]. The reasons for the other changes are too patent to require statement. *Id.*

Accordingly, in cases arising under the 1898 Act this Court consistently applied the *Neal v. Clark* formulation of "fraud" requiring intentional conduct. In *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 333 (1934), for example, the Court acknowledged the continuing vitality of Justice Harlan's interpretation of such statutory terms as "fraud" and "misappropriation while acting in a fiduciary capacity": "The meaning of these words has been fixed by judicial construction for very nearly a century." *Id.* The Court further pointed out that, "'[t]hrough the intervening years that precept has been applied by this Court in varied situations with unbroken continuity." *Id.* (citing cases). *See also In re Rice & Reuben*, 43 F.2d 378, 380 (D. Me.1930)

(relying on the *Neal v. Clark* definition of fraud to distinguish a non-dischargeable debt arising from actual fraud from a dischargeable debt arising from constructive fraud). As this Court consistently reiterated, a debtor seeking a discharge places "the rectitude of his prior dealings squarely in issue" because the Bankruptcy Act limited the opportunity for a discharge to the "honest but unfortunate debtor." *Brown v. Felsen*, 442 U.S. 127, 128 (1979), *citing Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).

In *Grogan v. Garner*, 498 U.S. 279, 290 (1991), the Court observed that by eliminating the requirement that the debt arising from fraud must be reduced to judgment in order to be dischargeable, a 1903 amendment to §17(a)(2) intentionally broadened the fraud exception to discharge. As the Court recognized, Congress thus returned to the historical antecedents of excepting from discharge all debts arising for the debtor's intentional wrongdoing (*id.*):

> As we explained in *Brown v. Felsen*, the 1898 Bankruptcy Act provided that "judgments" sounding in fraud were exempt from discharge. 30 Stat. 550. In the 1903 revisions, Congress substituted the term "liabilities" for "judgments." 32 Stat. 798. This alteration was intended to broaden the coverage of the fraud exceptions. *See Brown v. Felsen*, 442 U.S., at 138. Absent a clear indication from Congress of a change in policy, it would be inconsistent with this earlier expression of congressional intent to construe the exceptions to allow some debtors facing fraud judgments to have those judgments discharged.

In short, the relevant historical landscape is dominated by the "unbroken continuity" with which this Court has applied the *Neal v. Clark* standard. *Davis*, 293 U.S. at 331-32. That understanding — based on the distinction between intentional fraud and constructive fraud — provides the backdrop for an accurate interpretation of the 1978 Bankruptcy Code.

3. The Bankruptcy Code enacted in 1978 codified the *Neal v. Clark* distinction.

In enacting the Bankruptcy Code in 1978 (adding the term "actual fraud" to § 523(A)(2)(A)), Congress expressly recognized that wrongful intent, not misrepresentation, is the common thread

unifying the types of fraud for which discharge should be denied. The pivotal distinction between intentional and constructive fraud articulated in *Neal v. Clark* was carried forward in the Bankruptcy Code to except from discharge any debt arising from intentional fraud, even in the absence of a false representation from debtor to creditor. *See Archer v. Warner,* 538 U.S. 314, 316 (2003); *Cohen*, 523 U.S. at 217.

One of the few changes that the new Bankruptcy Code made to the predecessor section of § 523(a)(2)(A) was the insertion of the term "actual fraud" as a basis for denial of discharge. Congress made that change to codify this Court's long-standing precedents regarding wrongful intent and moral turpitude as "grounds for exception from discharge." H. Rpt. No. 95-595, at 364 (1978); *see also* S. Rpt. 95-989, at 77 (1978). *See* 1978 U.S.C.C.A.N. 5963, 6453 (95th Cong., 2d Sess.) (Statement of Hon. Don Edwards, Chairman of the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary) (inclusion of "actual fraud" in § 523(a)(2)(A) was for the purpose of "codify[ing] current case law e.g. *Neal v. Clark*, 95 U.S. 704 (1887), which interprets 'fraud' to mean actual or positive fraud rather than fraud implied in law").

This entrenched, well-understood view of the fraud exception to discharge continues to inform this Court's decisions. One instructive example from this Court's post-1978 jurisprudence: "The Bankruptcy Code has long prohibited debtors from discharging

liabilities incurred on account of their fraud, embodying a basic policy animating the Code...." *Cohen*, 523 U.S. at 217, *quoting Grogan v. Garner*, 498 U.S. at 287.

Examining the history and interpretation of the Bankruptcy Act of 1898, the Court explained (*Cohen*, 523 U.S. at 221):

> The history of the fraud exception reinforces our reading of § 523(a)(2)(A). The Bankruptcy Act of 1898 prohibited discharge of "judgments in actions for frauds, or obtaining property by false pretenses or false representations," § 17, 30 Stat. 550, and an award of punitive damages for fraud plainly fits in the category of "judgments in actions for fraud." The exception was broadened in 1903 to include all "liabilities for obtaining property by false pretenses or false representations," § 5, 32 Stat. 798, language that, *a fortiori*, encompasses liability for punitive damages. *See Brown*, 442 U.S., at 138 (interpreting the provision as prohibiting discharge of "all debts arising out of conduct specified" therein); *In re St. Laurent*, 991 F.2d, at 679 (noting "practice of holding debts for punitive damages nondischargeable" under this exception "if the compensatory damages ... were themselves nondischargeable"). And the

> Bankruptcy Act of 1978 enacted a "substantially similar" provision, *Brown*, supra, at 129, n. 1, barring discharge of "any debt ... for obtaining money, property, services, or ... credit, by ... false pretenses, a false representation, or actual fraud." 11 U.S.C. § 523(a)(2)(A) (1982 ed.).
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> As the result of a slight amendment to the language in 1984, referred to in the legislative history only as a "stylistic change," *see* S. Rep. No. 98–65, at 80 (1983), § 523(a)(2)(A) now excepts from discharge "any debt ... for money, property, services, or ... credit, to the extent obtained by ... false pretenses, a false representation, or actual fraud." We, however, "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." [*Pa. DPW v.*] *Davenport*, 495 U.S. at 563....

To similar effect, *Archer v. Warner*, 538 U.S. at 316, held that language in § 523(a)(2)(A) denying discharge for fraud could "cover a debt embodied in a settlement agreement that settled a creditor's earlier claim 'for money . . . obtained by . . fraud.'" In so holding, the Court found that it must decide whether the same debt, now embodied in a settlement

agreement and promissory note, could also "amount to a debt for *money obtained by fraud*" within the terms of § 523(a)(2)(A). Relying on *Brown v. Felson* and *Cohen v. de la Cruz*, the Court explained in *Archer* that "'Congress intended the fullest possible inquiry' to ensure that 'all debts arising out of fraud are 'excepted from discharge,' no matter what their form." *Archer*, 538 U.S. at 316, *citing Brown*, 442 U.S. at 138. And *Archer* explicitly recognized that §523(a)(2)(A) applies to all debts that arise out of fraud. *Id.* at 321, *citing Cohen v. de la Cruz*, 523 U.S. at 215.

Even more recently, the Court's opinion in *Bullock v. BankChampaign, N.A.*, 133 S.Ct. 1754, 1759-60 (2013) again harkened back to the definition of "fraud" set forth in *Neal v. Clark*. In interpreting § 523(a)(2)(A) in the context of defalcation, the Court explained:

> We base our approach and our answer upon one of this Court's precedents. In 1878, this Court interpreted the related statutory term "fraud" in the portion of the Bankruptcy Code laying out exceptions to discharge. Justice Harlan wrote for the Court:
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> "[D]ebts created by 'fraud' are associated directly with debts created by 'embezzlement.' Such association justifies, if it does not imperatively require, the conclusion that the 'fraud'

> referred to in that section means positive fraud, or fraud in fact, involving moral turpitude or intentional wrong, as does embezzlement; and not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality." *Neal v. Clark*, 95 U.S. 704 (1878).

4. Contrary to the Fifth Circuit's view, the common law does not compel a narrow definition of "actual fraud."

In holding that "actual fraud" in §523(a)(2)(A) requires that the debtor made a false representation to the creditor, the Fifth Circuit misperceived the rationale and continuing vitality of *Neal v. Clark*. The Fifth Circuit also misapplied this Court's guidance in *Field v. Mans*, 526 U.S. 59 (1995), invoking the Restatement (Second) of Torts as its sole source for understanding the common law view of fraud that existed when the Bankruptcy Act was enacted in 1978.

The Fifth Circuit looked only to §§ 537 and 540 of the Restatement (Second). But those two sections do not constitute the universe of common law that existed in 1978; they do not even exhaust what the Restatement (Second) has to say on the subject. The topic of fraud without the prerequisite of misrepresentation is the subject of extensive commentary in Restatement (Second) of Torts § 871

(1977), concerning intentional harm to a property interest.[2] *See Sauer v. Lawson, Inc.*, 791 F.3d 214 (1st Cir. 2015) (quoting Restatement (Second) of Torts § 871). Comment e to § 871 explains:

> The actor's conduct is fraudulent if he intentionally causes another to act or refrain from acting by means of intentionally false or misleading conduct or by his intentional concealment of facts or by his intentional failure to disclose a fact that he has a duty to reveal to the other. The rule stated in this Section applies to one who assists another to commit a fraud.

Looking beyond the convenient summary that the Restatement provides to the actual reported decisions indicated that, "[t]he common law not only gives no definition to fraud, but perhaps wisely asserts as a principle that there is no definition of it...." *McAleer v. Horsley*, 35 Md. 439, 452 (1872). In fact, the concept of fraud is left "general and flexible" by design so that courts an "match their astuteness against the versatile inventions of fraud doers." *Stonemets v. Head*, 154 S.W. 108, 114 (Mo. 1913).

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[2] Restatement (Second) Torts § 871 states: "One who intentionally deprives another of his legally protected property interest or causes injury to the interest is subject to liability to the other if his conduct is generally culpable and not justifiable under the circumstances."

The Fifth Circuit therefore was incorrect in its view that the common law regarded a false representation as a prerequisite to fraud in 1978. As the Seventh Circuit has concluded:

> No learned inquiry into the history of fraud is necessary to establish that it is not limited to misrepresentation and misleading omissions. "Fraud is a generic term, which embraces all the multifarious means which human ingenuity can devise and which are resorted to by one individual to gain an advantage over another by false suggestions or by suppression of truth. No definite and invariable rule can be laid down as a general proposition defining fraud, and it includes all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated."

McClellan v. Cantrell, 217 F.3d 890, 893 (7th Cir. 2000), *quoting Stapleton v. Holt*, 207 Okla. 443, 250 P.2d 451, 453-54 (Okla. 1952).

The common law does not limit the concept of actual fraud to a single, narrow definition requiring a misrepresentation, but instead recognizes that courts possess a degree of flexibility in assessing claims of fraud. "As the leading treatise on bankruptcy explains, '[a]ctual fraud, by definition, consists of any deceit, artifice, trick or design

involving direct and active operation of the mind, used to circumvent and cheat another.'" *Sauer v. Lawson* (*In re Lawson*), 791 F.3d at 219, *quoting* 4 Collier on Bankruptcy ¶ 523.08[1] [e] (A.N. Resnick & H.J. Somer, eds., 16th ed. 2015).

A brief survey of judicial decisions interpreting the term "actual fraud" prior to and contemporaneous with enactment of the Bankruptcy Code disproves the notion that the common law applied a uniform, static definition of actual fraud that turned on a material misrepresentation. To be sure, many cases list material misrepresentation as an element of fraud; but others do not.

For example, in *Wallace v. Wallace,* 291 S.E.2d 386, 387-88 (W.Va. 1982), a case involving an alleged fraudulent transfer intended to reduce an alimony award, the Supreme Court of Appeals of West Virginia offered a detailed analysis of longstanding common law fraud principles:

> "Fraud" is a generic term, encompassing many different and ever-innovative forms: ... [W]hile it has often been said that fraud cannot or should not be precisely defined, the books contain many definitions, such as unfair dealing; malfeasance, a positive act resulting from a wilful intent to deceive; an artifice by which a person is deceived to his hurt; a wilful, malevolent act, directed to perpetrating a wrong to the rights of

others; anything which is calculated to deceive, whether it is a single act or a combination of circumstances, or acts or words which amount to a suppression of the truth, or mere silence; deceitful practices in depriving or endeavoring to deprive another of his known right by means of some artful device or plan contrary to the plain rules of common honesty; the unlawful appropriation of another's property by design; and making one state of things appear to a person with whom dealings are had to be the true state of things, while acting on the knowledge of a different state of things. Fraud has been said to consist of conduct that operates prejudicially on the rights of others and is so intended; a deceitful design to deprive another of some profit or advantage; or deception practiced to induce another to part with property or to surrender some legal right, which accomplishes the end desired. Fraud therefore, in its general sense, is deemed to comprise anything calculated to deceive, including all acts, omissions, and concealments involving a breach or legal or equitable duty, trust, or confidence justly reposed, resulting in damage to another, or by which an undue and unconscientious advantage is taken of another[.] (citations omitted).

In *Loucks v. McCormick,* 424 P.2d 555, 560 (Kan. 1967), the Supreme Court of Kansas outlined the established common law distinction "between actual and constructive fraud":

> Fraud, in the sense of a court of equity, properly includes all acts, omissions, and concealments which involve a breach of a legal or equitable duty, trust, or confidence justly reposed, and are injurious to another, or by which an undue and unconscientious advantage is taken of another. 1 Story, Eq.Jur., § 187.
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> Constructive fraud consists in any act of omission or commission contrary to legal or equitable duty, trust or confidence justly reposed, which is contrary to good conscience, and operates to the injury of another. The former implies moral guilt; the latter may be consistent with innocence. [citation omitted].

Perhaps most important for present purposes is the fact that Congress specifically invoked this Court's *Neal v. Clark* model in enacting the Bankruptcy Code, thus focusing the availability of discharge on the presence of intentional misconduct rather than limiting the analysis to instances of false representation. And if further demonstration were needed that the *Neal v. Clark* formulation provides practical guidance that is consistent with the balance Congress sought to achieve, it can be found in the

recent experience of courts within the Seventh Circuit. Fifteen years ago, in *McClellan*, the Seventh Circuit applied the *Neal v. Clark* standard to the "actual fraud" category of § 523(a)(2)(A). *See* 217 F. 3d at 894. In the years since then, courts within that circuit have followed that holding without difficulty, and without the consequences about which the Fifth Circuit expressed concern in the decision below. *See, e.g., Forsythe v. Yeley*, 508 B.R. 82, 86 (S.D. Ind. 2014) (no fraud existed at the onset of the arrangement, but "actual fraud" existed when debtor took money from an account and used it for personal expenses); *Landmark Credit Union v. Reichartz* (*In re Reichartz*), 529 B.R. 696 (Bankr. E.D. Wisc. 2015) (describing the interplay among the three fraud exceptions in §523(a)(2)(A) subsequent to *McClellan); Eisenstein v. Eisenstein* (*In re Eisenstein*), 525 B.R. 428, 429 (Bankr. N.D. Ill. 2015) ("To establish a claim for actual fraud under § 523(a)(2)(A), a plaintiff must prove that (1) fraud occurred, (2) the debtor intended to defraud and (3) the fraud created the debt." *citing Wachovia Securities, LLC v. Jahelka* (*In re Jahelka*), 442 B.R. 663, 669 (Bankr. N.D. Ill. 2010); and *Metropolitan Real Estate Corp. v. Gard* (*In re Gard*), 327 B.R. 372, 375-376 (Bankr. N.D. Ind. 2003) (debtor made no misrepresentation to creditor but acted with "intent to defraud" when he closed on property purchase knowing that the tendered checks would not be honored).

To be sure, the Court has mentioned false representation from time to time in bankruptcy

cases; but only in cases that actually involved allegedly false representations, such as *Field v. Mans*. In dischargeability cases involving other forms of fraud, this Court made no mention of false representation as a required element. *See, e.g.*, *Archer*, 538 U.S. at 316; *Cohen*, 523 U.S. at 217.

5. Sound public policy supports the conclusion that § 523(A)(2)(A) does not limit "actual fraud" to false representations made by a debtor to a creditor.

A critical final point in understanding the relevant common law as it existed in 1978 (and continues to exist today): fraud was not then, and is not now, a static concept. As the forms of fraudulent conduct become more ingenious and sophisticated, as the technology for committing fraud becomes more complex and allows wrongdoers to deceive many people with a few barely detectable clicks, the Court should not abandon the established understanding that fraud comes in many forms. That newly-devised frauds may be more ingenious and sophisticated makes their victims all the more vulnerable. Common law and statutory notions of fraud have traditionally understood the vital importance of adapting to the ingenuity of intentional wrongdoers. In contrast, the decision below creates a safe harbor for fraud by erecting a buffer zone: so long as the wrongdoer makes no false representation to the victim, the § 523(a)(2)(A) exception from discharge does not apply. The standard articulated by the Fifth Circuit enables intentional wrongdoers to reap the

rewards of their dishonesty while further penalizing their victims. That standard strikes at the very integrity of the bankruptcy system. It should be rejected.

The Fifth Circuit's interpretation should also be rejected because it misperceives the relationship between §523(a)(2)(A) and other provisions in the Code. For example, the decision below refers to a potential redundancy between § 523(a)(2)(A) and § 523(a)(6) (as does the concurring opinion in the Seventh Circuit in *McClellan*). But § 523(a)(6) addresses different forms of conduct (*e.g.*, non-fraudulent malicious injury to property, such as arson). And § 523(a)(2)(A) is broader in subject matter (*e.g.*, it covers "any debt ... for money, ...services, or an extension, renewal, or refinancing of credit ..." in addition to "property"). Thus, some conduct may fit within (a)(2)(A) and not within (a)(6); the reverse is also true. And cases may arise that arguably fit into both sections. But the hypothetical possibility of some overlap is no reason to read "actual fraud" out of (a)(2)(A) altogether, or to construe that section in a way that conflicts with its plain meaning and legislative purpose. Indeed, under the Fifth Circuit's interpretation, the rest of (a)(2)(A) would also be vulnerable to the same analysis. The interpretation of § 523(a)(2)(A) that *amici* support conforms most faithfully to the

statutory language and to the balance the Bankruptcy Code is designed to achieve.[3]

Even if there were valid basis for concern about how § 523(a)(2)(A) "fits" with other provisions of the Code, the *Neal v. Clark* standard remains the optimal way to protect the balance Congress struck in the Bankruptcy Code. From the earliest days of

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[3] Similar reasons should lead the Court to reject suggestions that petitioner's interpretation would create an asymmetry between the Code's provisions governing a fraudulent transferor and a fraudulent transferee. First, the discharge provisions exist within a larger context for combatting fraud. Thus, for example, fraudulent transferors are subject to criminal liability under 18 U.S.C. § 152. Moreover, any difference in the scope of discharge available to transferors versus transferees is not inherently unreasonable. The transferee, as recipient of the property, may thus be the best — or only — party in a position to make the victim whole. Additionally, deterrence against further transfers by the fraudulent transferee is a reasonable legislative policy choice.

Consider also that a party who intentionally fraudulently transfers property to a co-conspirator commits a general fraud as to all creditors equally. Had that transfer not been made, the transferred property would be liquidated in a Chapter 7 case and all creditors share pro rata in the proceeds of that liquidation. As to the transferee, however, participation in the fraudulent transfer harms only one creditor — the one who is also a creditor of the transferor. The transferee's other creditors actually benefitted from the fraudulent transfer — it provided a deeper pool of assets that could be liquidated to the benefit of all of the transferee's creditors equally. That is why § 727, 11 U.S.C. § 727, is not implicated as to the transferee. Rather, specific harms to specific creditors are dealt with under § 523—that subset of creditors who were individually harmed can seek the creditor-specific remedy of nondischargeability of a specific debt.

the bankruptcy system, and reiterated as recently as statutory amendments in 2005 (Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 314(b), 119 Stat. 23, 88 (2005)), Congress has endeavored to ensure that victims of deliberate fraud are made whole. Congress has, moreover, singled out fraud as particularly undeserving of the benefits of discharge. Where fraud is committed by a debtor may be the last person in a position to make the victim whole (because the debtor has received property obtained by fraud and any subsequent reconveyance of the property may make it impossible to recover), a narrow reading of "actual fraud" that rewards the debtor with a discharge would upset the equilibrium of rights and obligations on which the bankruptcy system depends.

For that reason, Congress opted for the *Neal v. Clark* standard as best suited to protect the victims of fraud while providing a fresh start to honest debtors. It is, accordingly, more consistent with the stated policy of the Code as a whole to adhere to the well-established *Neal v. Clark* formulation rather than follow the Fifth Circuit's course of narrowing the definition of "actual fraud" in a way that offers a roadmap for fraud. The *amicus* brief filed by the National Association of Bankruptcy Trustees explains how a potential wrongdoer could reenact the frauds in *McClellan, Lawson,* and this case — and get away with it — if the Fifth Circuit's interpretation of § 523(a)(2)(A) is upheld. Br. *Amicus Curiae* on Behalf

of the National Association of Bankruptcy Trustees in Support of Petitioner, No. 15-145, at 6-12.

But the Fifth Circuit's interpretation is even more worrisome. A potential wrongdoer could learn from some recent high-profile frauds and concoct a scheme that — by making the wrongdoer remote from his victims, thus avoiding misrepresentations to creditors — enables the wrongdoer to commit fraud and still get a fresh start under the Bankruptcy Code.

Consider how the Fifth Circuit standard would operate, for example, in a variation on the circumstances presented by "a $3.85 billion Ponzi scheme perpetrated by Minnesota businessman Thomas J. Petters." *Ritchie Capital Management, L.L.C. v. Jeffries*, 653 F.3d 755, 757 (8th Cir. 2011). That scheme involved multiple entities (including a venture capital firm that employed numerous single-purpose entities) and multiple people (including executives of various Petters-related companies). *Id.* at 758. But the fraudulent scheme was also facilitated by feeder funds, which were independent entities that raised money from their own investors and passed funds along to a Petters entity. Thus, various barriers and buffers existed between the principal perpetrator of the fraud and the defrauded investors. *See Peterson v. Somers Dublin Ltd.*, 729 F.3d 741, 744 (7th Cir. 2013); *United States v. Reynolds*, 643 F.3d 1130, 1132 (8th Cir. 2011). Through these means, Mr. Petters avoided direct solicitation to investors and did not make false representations to the investors who dealt only with

their own hedge funds. *See United States v. Fry*, 792 F.3d 884, 886 (8th Cir. 2015).

The Madoff-related fraud offers yet another example of a Ponzi scheme implemented through multiple layers of entities from which an intentional wrongdoer could develop a scheme that separated the principal from large numbers of victims. Many of the more than 15,000 investors who filed fraud claims totaling billions of dollars had no direct contact with Mr. Madoff, but invested in feeder funds that passed money through to Madoff entities. *See Picard v. JPMorgan Chase & Co.* (*In re Bernard L. Madoff Securities LLC*), 721 F.3d 54, 60 (2d Cir. 2013); *see also In re Bernard L. Madoff Inv. Securities LLC*, 654 F.3d 229, 231 (2d Cir. 2011); *In re Bernard L. Madoff Inv. Securities LLC*, 424 B.R. 122, 127 (S.D.N.Y. 2010). Had Mr. Madoff sought the protection of the Bankruptcy Code, the line drawn by the Fifth Circuit in this case poses the distinct risk that debts owed to only the small subset of the 15,000 defrauded investors to whom Mr. Madoff himself made false representations would be excepted from discharge.

These contemporary fraud schemes exemplify why this Court's traditional formulation should remain in place. The Fifth Circuit's departure from the *Neal v. Clark* standard disturbs the balance of the Bankruptcy Code in ways that would have adverse economic consequences.

CONCLUSION

The judgment of the Fifth Circuit should be reversed and the case remanded for further proceedings.

Respectfully submitted.

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No. 15–145

IN THE

Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC.,

Petitioner,

v.

DANIEL LEE RITZ, JR.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF *AMICUS CURIAE* G. ERIC BRUNSTAD, JR. IN SUPPORT OF RESPONDENT

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INTEREST OF THE *AMICUS CURIAE*[1]

The undersigned *amicus curiae* is an Adjunct Professor of Law at the Georgetown University Law Center where he teaches courses on bankruptcy, secured transactions, and business reorganizations and international insolvency law. He is a former Visiting Lecturer in Law at the Yale Law School, where he began teaching in 1990, a former Adjunct Professor of Law at New York University School of Law, and has also taught at the Harvard Law School. In addition to his teaching, the undersigned is a contributing author for Collier on Bankruptcy, responsible for writing several chapters of the Treatise. He is also a partner at the law firm of Dechert LLP; a prior Chair of the ABA Business Bankruptcy Committee; a former member of the Judicial Conference Advisory Committee on the Federal Bankruptcy Rules; and a Fellow of the American College of Bankruptcy.

The undersigned has briefed and argued numerous bankruptcy matters before the Court, in-

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[1] No counsel for any party has authored this brief in whole or in part, and no party or counsel for a party has made a monetary contribution to the preparation or submission of this brief. *See* Sup. Ct. R. 37.6. Both petitioner and respondent have consented to the filing of this brief. Copies of petitioner's and respondent's consents are filed herewith.

cluding *Schwab v. Reilly*, 560 U.S. 770 (2010); *Milavetz, Gallop & Milavetz, P.A. v. United States*, 559 U.S. 229 (2010); *Florida Dep't of Revenue v. Piccadilly Cafeterias, Inc.*, 554 U.S. 33 (2008); *Travelers Cas. & Sur. Co. v. Pacific Gas & Elec. Co.*, 549 U.S. 443 (2007); *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365 (2007); *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004); and *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1 (2000). He has otherwise participated as counsel for one of the parties in numerous other bankruptcy matters before the Court, including *Executive Benefits Insurance Agency v. Arkison*, 134 S. Ct. 2165 (2014); *Stern v. Marshall*, 131 S. Ct. 2594 (2011); *Hamilton v. Lanning*, 560 U.S. 505 (2010); *Central Virginia Cmty. College v. Katz*, 546 U.S. 356 (2006); *Rousey v. Jacoway*, 544 U.S. 320 (2005); *Kontrick v. Ryan*, 540 U.S. 443 (2004); *Lamie v. United States Trustee*, 540 U.S. 526 (2004); *FCC v. NextWave Personal Commc'ns Inc.*, 537 U.S. 293 (2003); and *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249 (1992). In addition, he has prepared and filed with the Court numerous amicus briefs in bankruptcy cases, including *Bullard v. Blue Hills Bank*, 135 S. Ct. 1686 (2015); *Harris v. Viegelahn*, 135 S. Ct. 1829 (2015); *Wellness International Network, Ltd. v. Sharif*, 135 S. Ct. 1932 (2015); *Clark v. Rameker*, 134 S. Ct. 2242 (2014); *Law v. Siegel*, 134 S. Ct. 1188 (2014); *Bullock v. BankChampaign, N.A.*, 133 S. Ct. 1754 (2013); *RadLAX Gateway Hotel,*

LLC v. Amalgamated Bank, 132 S. Ct. 2065 (2012); *Hall v. United States*, 132 S. Ct. 1882 (2012); *Ransom v. FIA Card Servs.*, 562 U.S. 61 (2011); *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260 (2010); *Howard Delivery Serv., Inc. v. Zurich American Ins. Co.*, 547 U.S. 651 (2006); *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440 (2004); *Archer v. Warner*, 538 U.S. 314 (2003); and *Things Remembered, Inc. v. Petrarca*, 516 U.S. 124 (1995).

The undersigned is deeply interested in the subject of bankruptcy law and has written, taught, and lectured extensively on the subject of the bankruptcy discharge. The purpose of this brief is to address matters that bear on the Court's determination of a vitally important bankruptcy issue: whether the "actual fraud" exception to bankruptcy discharge relief in section 523(a)(2)(A) bars from discharge a debt for which the debtor is liable *not* because he intentionally and fraudulently obtained money, property, services, or credit from a creditor, but rather because he is deemed to be liable for the debts of his business under a veil piercing theory because he engaged in a "fraudulent conveyance" under state law by making transfers from his business.

The issue is important because, if accepted, Petitioner's theory of non-dischargeability would seriously impair discharge relief under the Bankruptcy Code by improperly expanding the

discharge exception of section 523(a)(2)(A) to encompass a broad range of debts without the need for a creditor to show, as section 523(a)(2)(A) requires, that the debtor owes a debt for money, property, services, or credit "obtained" through "actual fraud." That is because Petitioner's theory is *not* that Respondent owes a debt to Petitioner for goods "obtained" by fraud (which is what section 523(a)(2)(A) addresses), but rather that Respondent should not be excused from the debt because he participated in making fraudulent conveyances that resulted in Petitioner's claim going unpaid (which is beyond the scope of section 523(a)(2)(A)).

Petitioner's theory would also improperly expand section 523(a)(2)(A) because, under applicable fraudulent transfer law, fraudulent conveyance liability does not require a showing of "actual fraud." Rather, fraudulent transfer liability may be premised merely on a showing of "actual intent" to delay, hinder, or defraud, and one may be guilty of "actual intent" to delay, hinder, or defraud merely owing to the presence of four or five so-called "badges of fraud"—for example, where the debtor is insolvent, has been threatened with a debt-collection suit, makes a gift to a relative, and then incurs additional debt by making a significant charge on a credit card. In other words, the grounds for showing "actual intent" for fraudulent transfer purposes is quite different from, and less exacting than, what is

traditionally necessary to show "actual fraud" as the term is used in section 523(a)(2)(A).

This brief explains why the Fifth Circuit was correct in finding that the debt at issue falls outside the scope of section 523(a)(2)(A). The text of the provision, its context, relevant principles of statutory construction, and its history all counsel that the "actual fraud" exception of section 523(a)(2)(A) requires that the debtor have engaged in some kind of affirmative fraudulent conduct in *obtaining* money, property, services, or credit from the creditor, and simply does not encompass Petitioner's claim in this matter. This brief offers a unique contribution by focusing on how Petitioner's overreaching theory seriously threatens the integrity of discharge relief.

STATEMENT

Petitioner Husky International Electronics, Inc. ("Husky") is a seller of electronic device components. Pet. App. 2a. From 2003 to 2007, Husky sold and delivered goods to Chrysalis Manufacturing Corp. ("Chrysalis"), a company that manufactured electronic circuit boards, pursuant to a written contract. Pet. App. 2a, 38a. Chrysalis failed to pay for the goods it purchased from Husky, resulting in an unpaid debt of $163,999.38. Pet. App. 2a.

At all relevant times, Respondent Daniel Lee Ritz, Jr. ("Ritz") was a director and partial owner

of Chrysalis and was in financial control of the company. Pet. App. 2a. Between November 2006 and May 2007, Ritz caused Chrysalis to make several transfers of assets to other entities also under his control. Pet. App. 81a-82a. Husky sued Ritz in federal district court in May 2009, claiming that Ritz was personally liable for Chrysalis's debt under Texas law. Pet. App. 39a. On December 31, 2009, Ritz filed a voluntary chapter 7 bankruptcy petition. Pet. App. 79a. Thereafter, Husky initiated an adversary proceeding in Ritz's bankruptcy case, claiming that (1) due to his actions Ritz is personally liable for Chrysalis's debt, and (2) the alleged debt is non-dischargeable in Ritz's chapter 7 bankruptcy case. Pet. App. 78a-79a. As is relevant here, Husky claims that the debt is non-dischargeable under section 523(a)(2)(A) of the Bankruptcy Code, 11 U.S.C. § 523(a)(2)(A), which excepts from discharge "any debt" for "money, property, services, or an extension, renewal, or refinancing of credit to the extent obtained, [sic] by false pretenses, a false representation, or actual fraud . . . ." Pet. App. 79a.

Notably, Husky's contention is *not* that Ritz himself contracted with Husky to obtain the goods in question. Nor is it Husky's claim that Ritz fraudulently induced Husky to supply the goods by making some kind of misrepresentation. Rather, Husky's claim is that Ritz is liable for Chrysalis's debt for the goods on a combined state-law veil-piercing and fraudulent convey-

ance theory. Husky's veil piercing argument is that, under applicable Texas law, the owner of a corporation may be responsible for the corporation's debts if the owner "caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the [creditor] primarily for the direct personal benefit of the . . . owner . . . ." Tex. Bus. Orgs. Code § 21.223. Husky asserts that Ritz perpetrated an "actual fraud" as section 21.223 requires by invoking section 24.005(a)(1) of the Texas Uniform Fraudulent Transfer Act, Tex. Bus. & Com. Code § 24.005(a)(1). Section 24.005(a)(1) permits the avoidance of transfers made "with actual intent to hinder, delay, or defraud any creditor of the debtor." Husky's theory is that Ritz committed "actual fraud" for purposes of section 21.223 because Ritz made the transfers with "actual intent" to hinder, delay, or defraud Chrysalis's creditors under section 24.005(a)(1).

Notably, however, there is a critical difference between "actual fraud" and "actual intent" to hinder, delay, or defraud. A determination of "actual intent" to hinder, delay, or defraud under section 24.005(a)(1) does not require the kind of intentional wrongdoing traditionally associated with actual fraud. Rather, courts in Texas have held that "actual intent" to hinder, delay, or defraud for fraudulent transfer purposes may be demonstrated on the basis of the presence of four or five so-called "badges of fraud," which are listed non-exhaustively in section 24.005(b). *See*

Pet. App. 44a-45a n.13, 71a-72a. These "badges of fraud" include such things as (1) the debtor was insolvent when the transfer was made, (2) the debtor made the transfer without receiving in exchange reasonably equivalent value (e.g., the debtor made a gift), (3) the debtor made the transfer to an insider (e.g., to a relative), (4) the debtor had been sued or threatened with a suit before the transfer, and (5) the debtor incurred a significant debt shortly before or after making the transfer. Tex. Bus. & Com. Code § 24.005(b). Thus, fraudulent transfer liability under section 24.005(a)(1) may attach where a debtor is insolvent, has been threatened with a debt-collection suit (as many insolvent debtors are), makes a gift to a relative (such as by giving funds to a family member to buy medicine or pay the rent), and the debtor then incurs additional debt by making a significant charge on a credit card. This is far afield from the kind of conduct traditionally associated with "actual fraud."

The bankruptcy court rejected Husky's theory, concluding first that Ritz was not liable for Chrysalis's debt under Texas veil-piercing law (section 21.223 of the Texas Business Organizations Code) and, second, that the debt was not excepted from discharge under section 523(a)(2)(A), because Ritz had not committed "actual fraud" within the meaning of either statute. Pet. App. 91a-93a. "Actual fraud," the court noted, "is defined as 'the misrepresentation of a material fact with intention to induce action or

inaction, reliance on the misrepresentation by a person who, as a result of such reliance, suffers injury.'" Pet. App. 91a (citation omitted). Finding the record to be "wholly devoid of any such representation" on the part of Ritz, the court held that fraud had not been demonstrated either for purposes of Texas veil-piercing law or section 523(a)(2)(A) of the Bankruptcy Code. Pet. App. 92a.

On appeal, the district court disagreed with the bankruptcy court's veil-piercing determination, but agreed that the debt was not excepted from discharge under section 523(a)(2)(A). Pet. App. 72a. On the veil-piercing issue, the district court concluded that, because four or five "badges of fraud" were present in the case, Ritz's transfers from Chrysalis qualified as fraudulent conveyances under the "actual intent" provision of section 24.005(a)(1). Pet. App. 71a-72a. In turn, the court concluded that, because these transfers satisfied the "actual intent" requirement of section 24.005(a)(1), they also constituted "actual fraud" for purposes of section 21.223. Thus, the corporate veil could be disregarded.

On the dischargeability issue, however, the district court found the facts to be insufficient to satisfy section 523(a)(2)(A). In reaching its conclusion, the court cited *Field v. Mans*, 516 U.S. 59, 69 (1995) for the proposition that the term "actual fraud" in section 523(a)(2)(A) should be

construed according to its established common-law meaning. Pet. App. 72a. The court concluded that "[b]ecause the common law interpretation of § 523(a)(2)(A) requires a misrepresentation and there is no evidence here that Ritz made one, Husky's claim of nondischargeability under the statute fails." Pet. App. 73a.

On further appeal, the Fifth Circuit affirmed, also determining that the "actual fraud" exception to discharge under section 523(a)(2)(A) requires that the debtor have made some kind of false representation to the creditor. Pet. App. 6a-7a. "Guided by Supreme Court and Fifth Circuit precedent," Pet. App. 7a, the court below stated that this Court's decision in *Field* "appeared to assume that a false representation is necessary to establish 'actual fraud,'" Pet. App. 10a. The Fifth Circuit declined to follow the Seventh Circuit's decision in *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000), which held that "actual fraud" under section 523(a)(2)(A) included not only false representations, but also extended to "conveyances through which the debtor intends to hinder the creditor." Pet. App. 7a-8a. The Fifth Circuit reasoned that the *McClellan* decision was "in tension with" *Field* and noted that "[n]o subsequent appellate court has adopted the interpretation of Section 523(a)(2)(A) endorsed by the *McClellan* majority." Pet. App. 9a.

SUMMARY OF THE ARGUMENT

The bankruptcy discharge is a fundamental element of bankruptcy law that vindicates the primary bankruptcy policy of the "fresh start"—the idea that an insolvent debtor may be released from preexisting civil liabilities so that he or she may start over, free from the burden of oppressive indebtedness. Without the bankruptcy discharge, millions of insolvent individuals would remain locked in a state of perpetual indebtedness well beyond their ability to repay. Recognizing the centrality of discharge relief in the administration of bankruptcy cases, this Court has repeatedly stressed its importance in the interpretation of the Bankruptcy Code. *See, e.g., Schwab v. Reilly*, 560 U.S. 770, 803 (2010) (noting that the bankruptcy provisions "must be construed" in light of the policy "to give the bankrupt a fresh start" (citing *Burlingham v. Crouse*, 228 U.S. 459, 473 (1915))).

Although the Code provides generous discharge relief to insolvent individuals, this relief is not without limits. Among the limitations are those set forth in section 523(a)(2)(A), which excepts from discharge "any debt" for "money, property, services, or an extension, renewal, or refinancing of credit to the extent obtained, [sic] by false pretenses, a false representation, or actual fraud . . . ." 11 U.S.C. § 523(a)(2)(A). By its plain terms, this provision most naturally applies to a situation in which a debtor has "ob-

tained" from a creditor money, property, services, or credit through the use of some kind of intentional, affirmative fraud, such as by means of an outright deceit of some kind in enticing the creditor to provide goods or a loan. In this case, however, Ritz engaged in no such affirmative misconduct in acquiring any money, property, services, or credit from Husky. In fact, Ritz did not acquire anything from Husky—Chrysalis did. Nor did Ritz induce Husky to deliver any money, property, services, or credit on the basis of any kind of deceptive statement—as the bankruptcy court determined, the record is devoid of any evidence of any such thing. Rather, what Ritz stands accused of doing is making various transfers of funds from Chrysalis to other businesses that he controlled. This, however, is not the kind of conduct to which section 523(a)(2)(A) applies.

Husky's theory is that Ritz's conveyances constitute fraudulent transfers made with "actual intent" to hinder, delay, or defraud creditors within the meaning of section 24.005(a)(1) of the Texas Uniform Fraudulent Transfer Act. Tex, Bus. & Com. Code § 24.005(a)(1). Husky contends that this designation of "actual intent" is sufficient to establish that Ritz engaged in "actual fraud," not only for purposes of making Ritz liable for Chrysalis's debt to Husky under Texas veil-piercing law, but also to render the debt excepted from discharge under section 523(a)(2)(A). Husky's theory, however, does not square with

the text, context, purpose, or history of section 523(a)(2)(A). Moreover, if Husky's theory were accepted, it would improperly expand the scope of section 523(a)(2)(A) and seriously erode bankruptcy discharge relief.

Concededly, Ritz's transfers of funds from Chrysalis to other businesses he controlled may well have left Chrysalis with insufficient means to pay its bills, but that is not what section 523(a)(2)(A) addresses. Section 523(a)(2)(A) does *not* provide that a debtor who engages in a fraudulent transfer is barred from being discharged from his unpaid debts. On the contrary, a very different provision of the Bankruptcy Code, section 727(a)(2)(A), 11 U.S.C. § 727(a)(2)(A), governs that situation in a very precise and limited way—and one that does not assist Husky in this instance. Because section 523(a)(2)(A) does not address such circumstances, Husky's theory is an improper attempt to rewrite section 523(a)(2)(A) to govern matters beyond its scope.

More important, accepting Husky's interpretation would seriously undermine discharge relief generally. Under Texas fraudulent transfer law, a debtor may be determined to be guilty of "actual intent" to hinder, delay, or defraud if four or five so-called "badges of fraud" are present. *See* Pet. App. 44a-45a n.13, 71a-72a. These badges of fraud include such things as (1) the debtor was insolvent when the transfer was

made, (2) the debtor made the transfer without receiving in exchange reasonably equivalent value (e.g., the debtor made a gift), (3) the debtor made the transfer to an insider (e.g., to a relative), (4) the debtor had been sued or threatened with a suit before the transfer, and (5) the debtor incurred a significant debt shortly before or after making the transfer. Tex. Bus. & Com. Code § 24.005(b). Thus, an insolvent mother who has been threatened with a debt-collection action by a credit card company who gives her adult child a gift of money so the child can pay his rent just after making some significant charges on her credit card may be guilty of "actual intent" to hinder, delay, or defraud in making the gift to the child. Under Husky's theory, this, in turn, would qualify as "actual fraud" rendering the mother's unpaid debts non-dischargeable under section 523(a)(2)(A) simply because, by making the gift, she participated in a "fraudulent" scheme. That cannot be a correct interpretation of section 523(a)(2)(A), yet it is the logical consequence of Husky's theory. For these reasons, as well as those argued by Respondent, the decision of the Fifth Circuit rejecting Husky's erroneous interpretation should be affirmed.

ARGUMENT

The Fifth Circuit Concluded Correctly That Husky's Claim Does Not Fall Within The Scope Of Section 523(a)(2)(A).

Because section 523(a)(2)(A) applies only to certain kinds of "debts," it is critical at the outset to pinpoint precisely the debt at issue. Here, the relevant debt that Husky is attempting to collect from Ritz is Husky's claim for $163,999.38 for goods Husky sold to Chrysalis. Husky's theory of liability is *not* that Ritz fraudulently induced Husky to part with the goods Husky sold. Rather, Husky's theory is that, because Ritz participated in making fraudulent transfers from Chrysalis, the corporate veil between Ritz and Chrysalis should be pierced and Ritz held responsible for Chrysalis's liability. More precisely, Husky contends that the veil should be pierced on grounds of "actual fraud" under section 21.223 of the Texas Business Organizations Code because Ritz made the transfers with "actual intent" to hinder, delay, or defraud within the meaning of section 24.005(a)(1) of the Texas Fraudulent Transfer Act. Husky then contends that, because Ritz committed "actual fraud" for purposes of Texas's veil-piercing provision by reason of his "actual intent" to hinder, delay, or defraud under Texas fraudulent transfer law, Ritz's debt should be non-dischargeable under the "actual fraud" provision of section 523(a)(2)(A).

The initial problem with Husky's theory is that the particular *debt* that Husky is trying to enforce against Ritz—Husky's claim for $163,999.38 for goods sold to Chrysalis—is plainly not a debt for money, property, services, or credit *obtained by* fraud, and thus does not fall at all within the scope of section 523(a)(2)(A). Notably, Husky's overall theory of liability—that Ritz engaged in fraudulent transfers—*does* fall within the general purview of another discharge provision of the Bankruptcy Code, section 727(a)(2)(A). But a comparison of the terms of sections 727(a)(2)(A) and 523(a)(2)(A) reveals that their respective requirements are different. Moreover, these differences are important because they underscore why the decision below was correct.

Whereas section 523(a)(2)(A) applies only to specific debts, section 727(a)(2)(A) operates to deny *all* discharge relief of *all* of the debtor's debts in a chapter 7 proceeding if "the debtor, with intent to hinder, delay, or defraud a creditor . . . has transferred . . . property of the debtor, within one year before the date of the filing of [the debtor's bankruptcy case]." 11 U.S.C. § 727(a)(2)(A). By its terms, this provision addresses directly the dischargeability of a debtor's obligations where the debtor has engaged in fraudulent conveyances. This provision does not assist Husky, however, for two reasons. First, the provision applies only to the debtor's transfer of his own property. Second, it is limited to

transfers made within one year before the filing of the debtor's bankruptcy case. Here, the transfers in question did not involve Ritz's property and were made more than a year before he filed his chapter 7 petition.

In contrast, section 523(a)(2)(A) operates more surgically to deny a discharge only with respect to a particular "*debt* for money, property, services, or [credit] to the extent *obtained*, [sic] by false pretenses, a false representation, or actual fraud . . . ." 11 U.S.C. § 523(a)(2)(A) (emphasis added). As is relevant here, this section requires three basic things: (1) a debt (2) for money, property, services, or credit (3) obtained by actual fraud. But here the debt—the unpaid $163,999.38—was not for goods obtained by actual fraud. It was for goods Husky sold to Chrysalis under their contract. The alleged "fraud" in the matter occurred separately in the form of Ritz's participation in transfers from Chrysalis to other businesses. But section 523(a)(2)(A) does not deny the dischargeability of a debtor's debts simply because the debtor participated in a fraudulent transfer—that is the office of section 727(a)(2)(A) in a manner inapplicable to this case. Section 523(a)(2)(A) only denies a discharge for specific debts for money, property, services, or credit obtained by actual fraud. Husky attempts to elide the disparate elements of the two provisions with its argument that the relevant debt at issue here is nondischargeable under section 523(a)(2)(A) because

Ritz participated in a kind of fraudulent activity to Husky's detriment. *See, e.g.*, Pet. Br. at 14-15. But that is not what section 523(a)(2)(A) covers.

Seizing on this deficiency in Husky's approach, the Fifth Circuit correctly concluded that the debt Husky is attempting to collect from Ritz does not fall within the scope of section 523(a)(2)(A) because the debt is not one for money, property, services, or credit that Ritz obtained by actual fraud. More precisely, the court reasoned that, because the concept of "actual fraud" has traditionally required some kind of misrepresentation, Husky's failure to show that Ritz procured the goods through some kind of deceptive statement is fatal to Husky's claim. The Fifth Circuit was further correct in its holding because the fact that a debtor may be guilty of "actual intent" to hinder, delay, or defraud creditors for fraudulent transfer purposes is not a sufficient substitute for "actual fraud" under section 523(a)(2)(A). The concept of "actual intent" to hinder, delay, or defraud is different from, and less exacting than, the concept of "actual fraud." Interpreting section 523(a)(2)(A) to deny the dischargeability of a debt on the basis of the "actual intent" standard under fraudulent transfer law would vastly expand the scope of section 523(a)(2)(A), dislodging section 727(a)(2)(A), and imperiling discharge relief in innumerable settings far beyond anything Congress has provided for in the language it actually used in creating

its carefully tailored statutory scheme. The decision below should be affirmed.

A. Section 523(a)(2)(A) Should Be Construed Narrowly In Accordance With Its Plainly Expressed Terms.

Discharge relief has long been a critical aspect of bankruptcy law. *See Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (noting one of the primary purposes of bankruptcy law is to excuse an insolvent debtor "'from the weight of oppressive indebtedness, and permit him to start afresh'" (quoting *Williams v. U.S. Fidelity & Guaranty Co.*, 236 U.S. 549, 554-55 (1915))). Its importance is underscored by its breadth, applying generally as it does to "'*all debts that arose before the bankruptcy.*'" *FCC v. NextWave Personal Commc'ns Inc.*, 537 U.S. 293, 303 (2003) (quoting *Ohio v. Kovacs*, 469 U.S. 274, 278 (1985)) (emphasis in original); *see also* 11 U.S.C. § 1141(d) (providing discharge of "any debt" arising before confirmation of a plan, except for those debts excepted from discharge in section 523 of the Bankruptcy Code). Discharge relief is so important that the Bankruptcy Code prevents individuals from waiving it *ex ante* at the time they incur debt, *see* 11 U.S.C. § 524(a), and likewise places substantial *ex post* restrictions on the ability of debtors to waive the discharge with respect to particular debts, *see id.* § 524(c). Such protections reflect Congress's judgment that the discharge should remain broadly available, and

any impediments to invoking the discharge are rightfully limited to those Congress has expressly prescribed.

Reflecting this value, this Court has long followed the rule that the exceptions to discharge are to be "confined to those plainly expressed," *Gleason v. Thaw*, 236 U.S. 558, 562 (1915), and has rejected efforts to expand their reach through creative interpretations inconsistent with the wording of the statutory language used. *See Bullock v. BankChampaign, N.A.*, 133 S. Ct. 1754, 1760-61 (2013) (rejecting an interpretation of 11 U.S.C. § 523(a)(4) that would have broadened the defalcation exception); *Kawaauhau v. Geiger*, 523 U.S. 57, 62 (1998) (rejecting petitioner's broad interpretation of 11 U.S.C. § 523(a)(6) as "incompatible with the 'well-known' guide that exceptions to discharge 'should be confined to those plainly expressed'" (quoting *Gleason*, 236 U.S. at 562)). Indeed, the canon requiring tight construction of the discharge exceptions is by now a well-established tenet of bankruptcy jurisprudence, and was properly followed by the court below. *See* Pet. App. at 16a-17a; 4 COLLIER ON BANKRUPTCY ¶ 523.05 (16th ed. 2015) ("In determining whether a particular debt falls within one of the exceptions of section 523, the statute should be strictly construed against the objecting creditor and liberally in favor of the debtor. Any other construction would be inconsistent with the liberal spirit

that has always pervaded the entire bankruptcy system.").

In urging this Court to adopt its expansive reading of section 523(a)(2)(A), Husky's proposed interpretation—that participation in a fraudulent conveyance scheme under the "actual intent" standard of fraudulent transfer law is sufficient to constitute "actual fraud"—effectively urges the Court to abandon its longstanding practice, and with it the values that undergird Congress's ambitions for its fresh start policy. As it has in the past in cases involving even truly egregious facts, the Court should reject that offer.

In *Kawaauhau*, for example, the Court was presented with a creditor who had won a money judgment against a doctor for negligence resulting in the amputation of the creditor's right leg below the knee. 523 U.S. at 59. The doctor carried no malpractice insurance and declared bankruptcy soon after the judgment. *Id.* at 60. The patient sought to have the judgment excepted from discharge as a "willful and malicious injury" under section 523(a)(6) of the Bankruptcy Code, but this Court properly found that that exception, by its terms, only encompassed intentional torts where the debtor intended the injury, not simply negligence cases involving serious harm. *Id.* at 61-62. The judgment debt was therefore dischargeable.

Just as this Court rejected a strained reading of the statute in *Kawaauhau*, it should reject Husky's strained reading here. To hold otherwise would mark an unprecedented departure from this Court's well-established practice of construing tightly the exceptions to discharge relief.

B. The Text and Structure Of Section 523(a)(2)(A) Show That Congress Intended "Actual Fraud" To Require A Misrepresentation.

"The starting point in discerning congressional intent is the existing statutory text[.]" *Lamie v. U.S. Trustee*, 540 U.S. 526, 534 (2004) (citing *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 438 (1999)); *see also United States v. Ron Pair Enters.*, 489 U.S. 235, 241 (1989) ("The task of resolving the dispute over the meaning of [the statutory provision at issue] begins where all such inquiries must begin: with the language of the statute itself."). Here, the text and structure of section 523(a)(2)(A), together with its history, demonstrate that Congress intended to limit "actual fraud" to debts resulting from the debtor's misrepresentation to the creditor.

As noted, section 523(a)(2)(A) excepts from discharge "any debt for money, property, services, or [credit] . . . obtained, [sic] by false pretenses, a false representation, or actual fraud . . . ." 11 U.S.C. § 523(a)(2)(A). Congress added the

"actual fraud" term to section 523(a)(2)(A) in 1978, but the fraud exception itself dates back to earlier bankruptcy enactments. *See Field v. Mans*, 516 U.S. 59, 64-65 (1995) (discussing history of section 523(a)(2)(A)); *see also Cohen v. de la Cruz*, 523 U.S. 213, 221 (1998). As the Fifth Circuit noted below, Congress's addition of "actual fraud" in 1978 did not substantially change the scope of the fraud exception; the pre-1978 and post-1978 versions of the exception were "substantially similar." Pet. App. 15a (citing *Cohen*, 523 U.S. at 221). Its addition made clear that the fraud targeted by the exception was actual and positive fraud.

This Court previously construed the "actual fraud" term in *Field*, where it found that the term, along with "false pretenses" and "false representation" "carry the acquired meaning of terms of art" that "imply elements that the common law has defined them to include." *Field*, 516 U.S. at 69 (noting "'where Congress uses terms that have accumulated settled meaning under . . . the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms'") (citation omitted). In deciding the degree of reliance necessary to show "actual fraud," the Court looked to both the Restatement (Second) of Torts and Prosser's Law of Torts in effect at the time of the term's addition to the statute. *Id.* at 70. Following the lead of *Field*, the Fifth Circuit in this case looked to the

same sources to construe "actual fraud," finding that both indicated that, at common law, a false representation was a necessary prerequisite for "actual fraud." Pet. App. 11a-12a (discussing *Field*, 516 U.S. at 70; Restatement (Second) of Torts § 537 (1977); William J. Prosser, Law of Torts, § 106, p. 694 (4th ed. 1971)). As the Fifth Circuit further noted, not only did the *Field* Court assume that a false representation is necessary to establish "actual fraud," Justice Breyer's dissenting opinion affirmatively noted his support for the proposition. Pet. App. 10a; *see also Field*, 516 U.S. at 79 (Breyer, J., dissenting) ("I agree with the Court's holding that 'actual fraud' under 11 U.S.C. § 523(a)(2)(A) incorporates the common-law elements of intentional misrepresentation.").

Other authority supports the Fifth Circuit's reading of "actual fraud" as requiring a false representation at common law. When the Court considered, in *Bullock*, the meaning of "defalcation" in section 523(a)(4), it noted that "'[f]raud' typically requires a false statement or omission." *Bullock*, 133 S. Ct. at 1760 (citing W. LaFave, Criminal Law § 19.7 (5th ed. 2010)). Black's Law Dictionary is also in accord. *See* BLACK'S LAW DICTIONARY 775 (10th ed. 2014) (defining "actual fraud" as "[a] concealment or false representation through an intentional or reckless statement or conduct that injures another who relies on it in acting"). Finally, Collier's explains that to "sustain a prima facie case of [actual]

fraud, a plaintiff under section 523(a)(2) must establish that: (1) *the debtor made the representation*; (2) *at the time of the representation*, the debtor knew it to be false; (3) *the debtor made the representation* with the intent and purpose of deceiving the plaintiff; (4) the plaintiff justifiably relied *on the representation*; and (5) the plaintiff sustained a loss or damage as the proximate consequence of *the representation having been made*." 4 COLLIER ON BANKRUPTCY ¶ 523.08-[1][e] (16th ed. 2015) (emphasis added).

The Fifth Circuit's construction of "actual fraud" makes even more sense when looking at the rest of section 523(a)(2)(A). The provision requires that debt be "obtained, [sic] by . . . actual fraud." 11 U.S.C. § 523(a)(2)(A). Section 523(a)(2)(A) therefore explicitly requires causation—Congress limited the exception to those debts *caused* by a debtor's fraud. *See Field*, 516 U.S. at 66 (noting there is no dispute that "some degree of reliance is required to satisfy the element of causation in the phrase 'obtained by'"). For a debt to be caused by the debtor's fraud, the creditor needs to have relied on some action or omission by the debtor—a false representation. But under Husky's construction of "actual fraud," the creditor's reliance need be tied to nothing of the sort because, under Husky's theory, the creditor need only show that the debtor engaged in some kind of fraudulent activity not necessarily related to the incurrence of the debt—a formulation that makes little sense. *See*

Pet. Br. at 24 (arguing that actual fraud means intentional fraud without regard for whether the fraudulent conduct involved a misrepresentation).

Likewise, the causation requirement of section 523(a)(2)(A) demonstrates why Husky's attempt to limit *Field* to its facts does not succeed. *Field* determined that the crux of section 523(a)(2)(A) is reliance. *See Field*, 516 U.S. at 66. In doing so, its holding rested on the understanding that "actual fraud" requires a misrepresentation; otherwise, without a misrepresentation, there would be no basis to determine causation.

Applicable canons of statutory construction confirm the Fifth Circuit's reading of "actual fraud." Section 523(a)(2)(A) groups "actual fraud" alongside "false pretenses" and "false representation." Under the commonplace principle *noscitur a sociis*, whereby a word is known by the company it keeps, the meaning of "actual fraud" is informed by its neighbors—both of which require some representation by the debtor to the creditor. *See Yates v. United States*, 135 S. Ct. 1074, 1085 (2015) (noting *noscitur a sociis* prevents the Court from "'ascribing to one word a meaning so broad that it is inconsistent with its accompanying words, thus giving unintended breadth to the Acts of Congress'") (citation omitted); *see also United States v. Williams*, 553 U.S. 285, 294 (2008) ("a word is given more precise

content by the neighboring words with which it is associated"). Similarly, the principle *ejusdem generis* counsels that, "'where general words follow specific words in a statutory enumeration, the general words are [usually] construed to embrace only objects similar in nature to those objects enumerated by the preceding specific words.'" *Yates*, 135 S. Ct. at 1086 (quoting *Washington State Dep't of Social and Health Servs. v. Guardianship Estate of Keffeler*, 537 U.S. 371, 384 (2003)) (internal quotation marks omitted). Applying that principle here, the meaning of "actual fraud" is properly informed and cabined by the terms preceding it. As both false pretenses and false representation properly rest on a representation from debtor to creditor, so too should "actual fraud."

Section 523(a)(2)(A)'s larger statutory context further reinforces the notion that Congress never intended for "actual fraud" to serve as a catch-all provision, either for fraudulent activity generally or fraudulent transfer activity specifically. Section 523 contains other provisions directed specifically at particular kinds of fraudulent activity: for example, excepting from discharge debts based on materially false statements in writing respecting the debtor's or insider's financial condition, as well as debts resulting from fraud or defalcation while the debtor was acting in a fiduciary capacity, embezzlement, or larceny. 11 U.S.C. §§ 523(a)(2)(B), 523(a)(4). Moreover, as noted, an entirely separate provision of the

Bankruptcy Code denies discharge relief where a debtor has committed certain kinds of fraudulent transfers. *See* 11 U.S.C. § 727(a)(2)(A). Construing section 523(a)(2)(A) to include what section 727(a)(2)(A) already covers would effectively render the latter provision superfluous—a result to be avoided. *See TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001) ("It is 'a cardinal principle of statutory construction' that 'a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.'" (quoting *Duncan v. Walker*, 533 U.S. 167, 174 (2001))). In sum, consistent with the Court's reasoning in *Field*, these principles of statutory interpretation likewise reinforce the conclusion that Husky's proposed interpretation of section 523(a)(2)(A) is unsound and the decision below is correct.

C. If Accepted, Husky's Interpretation of Section 523(a)(2)(A) Would Seriously Undermine Discharge Relief.

Husky contends that its interpretation of section 523(a)(2)(A) is defensible on the ground that, in this instance, the fresh start policy is outweighed by "the interest of defrauded creditors in 'being made whole.'" Pet. Br. at 53 (quoting *Cohen*, 523 U.S. at 222). But apart from the fact that this is a judgment best reserved for Congress that Congress has not, in fact, expressed in the governing statutory text, Husky's interpretation would potentially deny discharge

relief to a vast assortment of debtors who did not actually intend to defraud anyone. That is so because of the nature of fraudulent transfer liability.

As noted, a debtor may be guilty of "actual intent" to hinder, delay, or defraud under the Texas law of fraudulent transfers (which is similar to the fraudulent transfer laws of most states) if the creditor proves the existence of four or five so-called "badges of fraud," which are listed non-exhaustively in section 24.005(b) of the Texas Uniform Fraudulent Transfer Act, Tex. Bus. & Com. Code § 24.005(b). *See* Pet. App. 44a-45a n.13, 71a-72a. These "badges of fraud" include such things as (1) the debtor was insolvent when the transfer was made, (2) the debtor made the transfer without receiving in exchange reasonably equivalent value (e.g., the debtor made a gift), (3) the debtor made the transfer to an insider (e.g., to a relative), (4) the debtor had been sued or threatened with a suit before the transfer, and (5) the debtor incurred a significant debt shortly before or after making the transfer. Tex. Bus. & Com. Code § 24.005(b). Thus, as noted previously, fraudulent transfer liability may attach where an insolvent debtor who has been threatened with a debt-collection action makes a gift to a family member and then incurs some additional debt by making a significant charge on a credit card. These considerations can be mixed and matched in all kinds of ways to encompass many situations in which the debtor did

not actually intend to defraud anyone, but nonetheless ran afoul of the strictures of the fraudulent conveyance laws. This is plainly not what Congress had in mind when it enacted section 523(a)(2)(A). Yet it is the logical extension of Husky's theory.

Take, for example, an insolvent debtor who makes a substantial payment to a hospital in order to pay for a treatment for an ill parent. If a creditor previously threatened the debtor with a debt-collection suit (such as in a letter threatening to take collection action if a debt is not paid), and the debtor makes a significant charge on the debtor's credit card shortly before or after making the payment, the debtor could be guilty of "actual intent" to hinder, delay, or defraud creditors, in which event none of the debtor's debts would be discharged under Husky's reading of section 523(a)(2)(A). This goes too far.

Ignoring the harmful effects that Husky's construction of section 523(a)(2)(A) would inflict on the current system of bankruptcy relief, certain of Husky's *amici* argue that the decision below should be overturned because it could be used to benefit debtors who intentionally defraud their creditors while purposefully avoiding any misrepresentation, thereby intentionally evading section 523(a)(2)(A). *See* Br. of Bankruptcy Law Profs. as *Amici Curiae* in Support of Petitioner at 28. These *amici* offer as an illustration a Ponzi scheme executed through multiple layers

of feeder funds whereby the ultimate perpetrator of the fraud never makes any actual representation to the hundreds or thousands of investors harmed by the fraud. *Id.* at 28-29. This hypothetical, however, is both unusual and overwrought. First, such schemes typically constitute federal crimes that entail criminal restitution obligations that are not dischargeable under section 523(a)(13). 11 U.S.C. § 523(a)(13). Second, even if any resulting civil liability might not be excepted from discharge under section 523(a)(2)(A), this does not mean that some other exception would not apply There are several potential candidates, including the exception for debts for fraud while acting in a fiduciary capacity, *id.* § 523(a)(4), if the debtor "has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information from which the debtor's financial condition or business transactions might be ascertained," *id.* § 727(a)(3), or if the debtor is unable "to explain satisfactorily any loss of assets or deficiency of assets to meet the debtor's liabilities, *id.* § 727(a)(5).

In reality, the far more pressing concern is not that perpetrators of Ponzi schemes will find shelter in the arms of the bankruptcy court, but rather that Husky's reading stretches section 523(a)(2)(A) too far and would deny discharge relief to debtors Congress intended to assist with a fresh start. Indeed, under Husky's theory, the denial of a discharge could become the rule for

many ordinary debtors rather than the exception. Husky's theory is thus unsound.

CONCLUSION

For the foregoing reasons, as well as those briefed by Respondent, the decision of the court below should be affirmed.

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In the Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC.,

Petitioner,

v.

DANIEL LEE RITZ, JR.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF *AMICUS CURIAE* ON BEHALF OF THE NATIONAL ASSOCIATION OF BANKRUPTCY TRUSTEES IN SUPPORT OF PETITIONER

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INTEREST OF THE *AMICUS CURIAE*[1]

This *amicus curiae* brief in support of Petitioner is submitted by the National Association of Bankruptcy Trustees ("NABT"), a non-profit association formed in 1982 that is the premier national professional organization of bankruptcy trustees. Over 75% of the approximately 1,100 active chapter 7 bankruptcy trustees are NABT members.

The mission of the NABT is to support the work of its trustee members and to promote the effectiveness and integrity of the bankruptcy system. NABT is intimately familiar with the practical issues associated with chapter 7 cases and has a strong interest in ensuring that the United States Bankruptcy Code, 11 U.S.C. § 101 *et seq.* (the "Code" or the "Bankruptcy Code"), is interpreted and administered in a manner that promotes fair and honest conduct by debtors in the hundreds of thousands of chapter 7 cases assigned to NABT's trustee members each year.[2] But the NABT's

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[1] All parties have consented to the filing of this *amicus* brief. No counsel for any party authored this brief in whole or in part. No party and no counsel for any party made a financial contribution to the preparation of this brief.

[2] In the twelve month period ending September 30, 2014, 533,572 individual chapter 7 bankruptcy petitions were filed in the United States. *See* News Release, Administrative Office of the U.S. Courts, reprinted at http://www.uscourts.gov /statistics/table/f-5a/bankruptcy-filings/2015/09/30 (last accessed December 18, 2015). Allocated among the approximately 1,100 chapter 7 trustees, each chapter 7 trustee

mission is subverted, and the trust of debtors and creditors alike in the integrity of the bankruptcy system is compromised, when unquestionably dishonest debtors like the one in this appeal are allowed to discharge individual debts associated with their misconduct.

Chapter 7 trustees owe a duty and responsibility to all creditors to pursue and recover assets for the estate, including assets that have been fraudulently transferred through schemes such as the one employed by the debtor in this case. *See* 11 U.S.C. §§ 704(a)(1) (duty to liquidate estate assets); 544(b) (power to avoid transfers under applicable state laws); and 548(a)(1)(A) (power to avoid fraudulent transfers). Chapter 7 trustees can also seek to deny a debtor a general discharge if the debtor fraudulently transfers assets within a year of filing bankruptcy with the actual intent to defraud creditors. 11 U.S.C. § 727(a)(2)(A). Moreover, a debtor may not receive a discharge of any debt obtained by "actual fraud." 11 U.S.C. § 523(a)(2)(A).

But the narrow definition of "actual fraud" adopted by the Fifth Circuit would cripple the ability of chapter 7 trustees to discharge their duties and would create an opening for debtors to fraudulently transfer and later dissipate assets with impunity through well-timed bankruptcy filings. By interpreting "actual fraud" under section

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receives an average of nearly 500 new chapter 7 cases every year. This new caseload is in addition to chapter 7 cases still pending from prior years that have yet to be fully administered and closed.

523(a)(2)(A) as not applying to debtors who — without affirmatively making any false representations — fraudulently transfer assets with the specific intent to defraud their creditors, the Fifth Circuit's decision undermines the very foundation of the Bankruptcy Code.

This appeal is critically important to the NABT because the decision below conflicts with the Bankruptcy Code's discharge provisions and underlying policy and perversely rewards some of the most dishonest of all debtors. The following discussion explains that section 523(a)(2)(A) of the Code should not be construed to create a path for dishonest debtors to receive a discharge simply by not making false representations to the creditors they cheat.

SUMMARY OF THE ARGUMENT

The decision below, interpreting "actual fraud" in section 523(a)(2)(A) of the Bankruptcy Code as limited to instances where the debtor affirmatively makes a false representation, creates a dangerous loophole through which the boldest and most dishonest debtors can "game the system" and achieve a complete discharge by silently transferring assets to insiders or other co-conspirators and then manipulating the timing of their bankruptcy petitions. By refraining from making any false representations to the creditors they cheat and by waiting more than a year after they fraudulently transfer their assets to file bankruptcy, dishonest debtors can both prevent their cheated creditors from blocking the discharge of their individual debts under section 523(a)(2)(A) of the Code and also block their chapter 7 trustees and creditors from objecting to their general discharge under section 727(a)(2)(A) of the Code. Worse still, debtors who do not consume or otherwise dissipate fraudulently conveyed assets but, instead, convert them into exempt assets before filing for bankruptcy, will be able to keep such property from their targeted victims forever. *See* 11 U.S.C. § 522.

Conversely, the more expansive definition of "actual fraud" embraced by the First and Seventh Circuits, which recognizes that "actual fraud" includes fraudulent conveyances made with the actual intent to defraud specific creditors, forecloses such "gaming" and is consistent with the fundamental principle that discharge through

bankruptcy is reserved only for honest but unfortunate debtors who are worthy of a discharge.

ARGUMENT

THE FIFTH CIRCUIT'S DECISION CONFLICTS WITH THE BANKRUPTCY CODE'S FUNDAMENTAL PURPOSE OF PROTECTING "HONEST BUT UNFORTUNATE" DEBTORS AND UNDERMINES THE ABILITY OF CHAPTER 7 TRUSTEES TO ADMINISTER CASES EFFECTIVELY.

The phrase "actual fraud" as used in section 523(a)(2)(A) is not defined by the Bankruptcy Code and, accordingly, should be given its ordinary and customary meaning. *E.g., Perrin v. United States*, 444 U.S. 37, 42 (1979) ("A fundamental canon of statutory construction is that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning."). The Restatement (Second) of Torts — which this Court referenced in *Field v. Mans*, 516 U.S. 59, 70 (1995), as "the most widely accepted distillation of the common law of torts" — recognizes that intentional interference with property rights can amount to fraud. *See* Restatement (Second) of Torts § 871 (1977) ("One who intentionally deprives another of his legally protected property interest or causes injury to the interest is subject to liability to the other if his conduct is generally culpable and not justifiable under the circumstances."). Similarly, Collier's leading treatise on bankruptcy does not

limit the definition of "actual fraud" in section 523(a)(2)(A) of the Code to instances where the debtor has affirmatively made a false representation, but, rather, states that "[a]ctual fraud, by definition, consists of any deceit, artifice, trick, or design involving direct and active operation of the mind, used to circumvent and cheat another — something said, done or omitted with the design of perpetrating what is known to be a cheat or deception." 4 COLLIER ON BANKRUPTCY ¶ 523.08[1][e] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2015). Thus, whether swindled by a debtor's affirmative misrepresentation or cheated by a debtor who transfers assets rather than pay his debts, creditors in both instances are victims of a debtor's "actual fraud."

The NABT is deeply concerned that the Fifth Circuit's narrow definition of "actual fraud" — limited to instances where the debtor has affirmatively made a false representation — effectively and unjustifiably insulates the silent schemer from adverse consequences that ought to flow from his misconduct. Such a restricted definition of "actual fraud" can render chapter 7 trustees and creditors powerless to stop dishonest debtors from transferring assets to their cronies at the expense of their creditors. Enterprising conmen who engage in elaborate, but silent, schemes to defraud their creditors will be able to exploit the bankruptcy system to preserve the fruits of their fraud and obtain a discharge of their debts — simply by not affirmatively making false representations to the creditors they defraud. These unscrupulous

schemers should not receive a discharge of debts they incur through elaborate machinations to cheat their creditors. *See Grogan v. Garner*, 498 U.S. 279, 287-88 (1991) ("[i]n the same breath that we have invoked this 'fresh start' policy, we have been careful to explain that the Act limits the opportunity for a completely unencumbered new beginning to the 'honest but unfortunate debtor'"); *Cohen v. de la Cruz*, 523 U.S. 213, 217 (1998) (the Bankruptcy Code "has long prohibited debtors from discharging liabilities incurred on account of their fraud, embodying a basic policy animating the Code of affording relief only to an honest but unfortunate debtor").

Consider the fraud perpetrated by Ritz, the debtor in the case currently before the Court. His company, Chrysalis Manufacturing Corp. ("Chrysalis"), owed nearly $165,000 to Husky International Electronics ("Husky") for unpaid goods. *See Husky Int'l Elecs., Inc. v. Ritz (In re Ritz)*, 787 F.3d 312, 314 (5th Cir. 2015). While the debt to Husky was outstanding, and without making a false statement to anyone, Ritz went to extraordinary lengths to render Chrysalis judgment-proof by causing Chrysalis to fraudulently transfer over a million dollars to multiple other Ritz-affiliated entities. After Husky sued Ritz seeking to hold him personally liable for the debt, Ritz filed a chapter 7 petition. *Id.* at 315. Husky responded by filing an adversary complaint seeking to declare its debt exempt from Ritz's general discharge under the "actual fraud" exception in section 523(a)(2)(A) of the Bankruptcy Code. Yet solely because Ritz did not

affirmatively make a false representation to Husky, the Fifth Circuit ruled that Ritz was entitled to a discharge of Husky's debt. *Id.* at 321 ("[W]e conclude that a representation is a necessary prerequisite for a showing of 'actual fraud' under Section 523(a)(2)(A). Because the parties agree that the record contains no evidence of such a representation, discharge of the debt at issue is not barred under this provision.").

In another case currently before this Court on a Petition for Writ of *Certiorari*, the debtor's misconduct followed a similar pattern. *See Sauer v. Lawson (In re Lawson)*, 791 F.3d 214 (1st Cir. 2015), *petition for cert. filed*, 84 U.S.L.W. 4 (July 24, 2015) (No. 15-113). The eventual debtor, Carrie Lawson ("Lawson"), formed a shell entity called Commercial Construction M&C, LLC ("Commercial Construction") shortly before a near $170,000 fraud-based judgment was entered against Lawson's father and in favor of Sauer Incorporated ("Sauer"). *Id.* at 217. After judgment was entered, and without making a false representation to anyone, Lawson's father transferred over $100,000 to Commercial Construction to keep those funds out of Sauer's reach. During the next year, and complicit with her father's scheme to defraud Sauer, Lawson transferred $80,000 from Commercial Construction to herself. Sauer later successfully sued Lawson for the fraudulent transfers in Rhode Island state court. Lawson responded with a chapter 13 bankruptcy petition, and Sauer sued to deem its debt non-dischargeable under section 523(a)(2)(A) based on

Lawson's actual fraud.[3] Noting that the Fifth Circuit had arrived at a different conclusion, *id.* at 216, n.1, and after an exhaustive analysis of the meaning of the phrase "actual fraud" at common law and the text and legislative history of section 523(a)(2)(A), the First Circuit held that "the 'actual fraud' exception to discharge under § 523(a)(2)(A) includes knowing receipt of a fraudulent conveyance where such receipt constituted actual (as opposed to constructive) fraud." *Id.* at 225.

Similarly, the Seventh Circuit has also addressed the meaning of "actual fraud" in section 523(a)(2)(A) in the context of a debtor's scheme to transfer assets with the actual intent to defraud a specific creditor. In *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000), the Plaintiff, Harold McClellan, sold machinery valued at $200,000 to the brother of the eventual debtor, Bobbie Cantrell ("Cantrell"). *Id.* at 892. After the debt had been paid down to $100,000, McClellan sued Cantrell's brother in state court to recover the balance and for an injunction to prevent the brother from transferring the machinery. While the lawsuit was pending but before an injunction could be entered — and without Cantrell making any false representations to anyone — the brother "sold" the machinery to Cantrell for $10. Cantrell, who "was colluding with her brother to thwart McClellan's collection of the debt," then turned around and sold the machinery for $160,000. *Id.* at 892. A year later, McClellan

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[3] Section 523(a)(2)(A) applies in chapter 13 cases. *See* 11 U.S.C. § 1328(a)(2).

added Cantrell as a defendant in his state court lawsuit against her brother, "claiming that her brother's transfer of the machinery to her had been a fraudulent conveyance." *Id.* Two years after that, Cantrell filed a chapter 7 petition, and McClellan sued Cantrell to deem his debt exempt from her general discharge based on actual fraud under section 523(a)(2)(A) of the Bankruptcy Code. Rejecting the narrow view of "actual fraud" later adopted by the Fifth Circuit, the Seventh Circuit concluded that Cantrell's collusion with her brother constituted "actual fraud" even though she did not make any false representations:

> No learned inquiry into the history of fraud is necessary to establish that it is not limited to misrepresentations and misleading omissions. "Fraud is a generic term, which embraces all the multifarious means which human ingenuity can devise and which are resorted to by one individual to gain an advantage over another by false suggestions or by the suppression of truth. No definite and invariable rule can be laid down as a general proposition defining fraud, and it includes all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated."

Id. at 893, *quoting Stapleton v. Holt*, 250 P.2d 451, 453-54 (Okla. 952).

The pattern in all of these cases is remarkable and unmistakable. Either for their own personal gain or to further a scheme orchestrated by another, these unscrupulous debtors engaged in elaborate machinations to transfer assets with the actual intent to defraud creditors. In each case, the last step was to file for bankruptcy and seek a general discharge of their debts, including the debts owed to the very creditors they intentionally cheated. Had these debtors filed for bankruptcy within a year of the fraudulent transfers of their assets, their chapter 7 trustees[4] could, and likely would, have filed complaints under section 727(a)(2)(A)[5] of the Bankruptcy Code seeking to deny their general discharge. But because the transfers occurred more than a year before their respective bankruptcy filings — with such delay no doubt due in large part to the debtors' efforts to hide assets and evade

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[4] Under section 727(c) of the Code, chapter 7 trustees have standing to object to a debtor's discharge. 11 U.S.C. § 727(c). Section 727 is not applicable in chapter 13 cases and would not have applied to Lawson.

[5] Under section 727(a)(2)(A) of the Code, a debtor can be denied a general discharge if the debtor

> with intent to hinder, delay or defraud a creditor . . . has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated or concealed — (A) property of the debtor, within one year before the date of the filing of the petition . . . .

11 U.S.C. § 727(a)(2)(A).

creditors — and may not have included transfers of the debtor's own assets, that relief was unavailable. Moreover, fraudulent conveyance actions under section 548(a)(1)(A) of the Bankruptcy Code[6] or under applicable state laws[7] would have been equally unavailing because, by all accounts, the fraudulently conveyed property was nowhere to be found.

The only recourse in these and similar cases is for the defrauded creditor to seek to exempt its debt from discharge under the "actual fraud" exception in section 523(a)(2)(A) of the Bankruptcy Code. But

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[6] Under section 548(a)(1)(A) of the Code, a

> trustee may avoid any transfer . . . of an interest of the debtor in property, or an obligation . . . incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily — (A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud an entity to which the debtor was, or became, on or after the date such transfer was made or such obligation was incurred, indebted. . . .

11 U.S.C. § 548(a)(1)(A).

[7] Under section 544(b) of the Code, 11 U.S.C. § 544(b), a trustee has strong-arm powers to avoid transfers that would be avoidable under applicable state law. *See, e.g. Leibowitz v. Parkway Bank & Trust Co. (In re Image Worldwide)*, 139 F.3d 574, 576-77 (7th Cir. 1998) ("under the strong-arm provision of the Bankruptcy Code, 11 U.S.C. § 544(b), the trustee can avoid any transaction of the debtor that would be voidable by any actual unsecured creditor under state law").

defrauded creditors will have no remedy if the "false representation" loophole recognized by the Fifth Circuit becomes a permanent fixture of the Code. The Fifth Circuit's decision turns the Code's objective of helping honest but unfortunate debtors on its head and perversely fashions a road map for dishonest debtors to become quite fortunate debtors. By transferring assets more than a year before filing bankruptcy and by carefully avoiding making any false representations, all their debts, including debts owed to the very creditors targeted by their now successful fraudulent schemes, would be discharged. The Seventh Circuit was correct in *McClellan* when it stated that such misconduct by debtors "is as blatant an abuse of the Bankruptcy Code as we can imagine. It turns bankruptcy into an engine for fraud." *McClellan*, 217 F.3d at 893.

The 850 trustee members of the NABT are charged with the responsibility of administering over four hundred thousand new chapter 7 bankruptcy cases filed each and every year. Their ability to do so is dependent, in large measure, on the honesty and integrity of the debtors that appear in the cases they administer. It is antithetical to the integrity of the bankruptcy system and undermines the ability of NABT's trustee members to effectively administer cases if unscrupulous debtors can escape responsibility for their misconduct simply by not making any false representations to the creditors they cheat.

CONCLUSION

For the foregoing reasons, the decision of the Fifth Circuit below should be reversed.

Respectfully submitted,

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No. 15-145

IN THE

Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC.
Petitioner,

v.

DANIEL LEE RITZ, JR.
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF OF *AMICUS CURIAE* THE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS IN SUPPORT OF THE RESPONDENT, DANIEL LEE RITZ, JR.

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INTEREST OF THE *AMICUS CURIAE*[1]

Incorporated in 1992, the National Association of Consumer Bankruptcy Attorneys ("NACBA") is a non-profit organization with a membership of more than 3,000 consumer bankruptcy attorneys nationwide. NACBA's mission includes educating the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process. Additionally, NACBA advocates nationally on issues that cannot adequately be addressed by individual member attorneys. It is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors. NACBA has filed *amicus curiae* briefs in various courts on behalf of consumer bankruptcy debtors. *See, e.g.*, *Lamie v. U.S. Trustee*, 124 S.Ct. 1023 (2004)(discussing § 330); *Hamilton v. Lanning*, 130 S. Ct. 2464 (2010); *United Student Aid Funds v. Espinosa*, 130 S. Ct. 1367 (2010); *Mort-Ranta v. Gorman*, 721 F.3d 241 (4th Cir. 2013); *Weber v. SEFCU*, 719 F.3d 72 (2d Cir. 2013).

Amicus urges the Court to affirm the decision of the Fifth Circuit, and thereby to retain the existing principle that debt does not become non-dischargeable under 11 U.S.C. § 523(a)(2)(A), unless the objecting creditor can establish that the debtor made a "misrepresentation" that induced the creditor to enter into the credit transaction. Petitioner urges a change in the law that would eliminate this requirement, and

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[1] Letters of consent have been filed with the Clerk. Pursuant to Supreme Court Rule 37.6, *amicus curiae* state that no counsel for a party has authored this brief in whole or in part, and no person or entity, other than *amicus curiae* or their counsel, made a monetary contribution to the preparation or submission of this brief.

deny a discharge to individuals who, sometimes years later, are alleged to have participated in a fraudulent transfer. We write to address this issue of transferee liability.

The impact from reversal of the Fifth Circuit decision will be felt mostly by honest Chapter 7 debtors, those who are entrepreneurs and owners of small and medium sized businesses that faced distress. The size of this group is significant. "One in seven individuals in the bankruptcy system is a struggling entrepreneur."[2] The Chapter 7 debtor who was or is "self-employed, tends to be "distinct financially from other bankruptcy debtors."[3] It is this group of honest debtors for whom loss of a discharge based on alleged transfers is particularly harmful. This is because transfers that may become labelled as "constructively fraudulent" under the Code are the same transfers that are the daily stuff of a small to medium sized businesses. The ability to deny an individual debtor a discharge based on transferee "fraud" will become a potent weapon that is likely to

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[2] Robert M. Lawless and Elizabeth Warren, *The Myth of the Disappearing Business Bankruptcy*, 93 CAL. L. REV. 743, 786 (2005). "And yet about one in seven bankrupt filers . is someone trying to cope with the collapse of a small business."

[3] Robert M. Lawless, *Striking Out on their Own: The Self Employed in Bankruptcy, in* BROKE: HOW DEBT BANKRUPTS THE MIDDLE CLASS, (Katherine Porter ed, 2012) p. 103. Professor Lawless has made an extensive study of the "self-employed," and how they fare in bankruptcy. He defines "self-employed" as including those who are the sole or primary owner of a corporation or other entity, as well as "sole proprietors" of a business. His research discloses that 36.5 percent of self-employed in bankruptcy operated as corporations, limited partnerships, limited liability companies, or similar entity . " *Id.* at 109.

be fiercely used against the owners of small and medium businesses, and will distort both the letter and policy of the Code. Creditors in the position of Husky International already have ample protection under § 523(a)(6), and have no need for the outcome sought by Petitioner.

SUMMARY OF THE ARGUMENT

The issue before this Court is not merely whether an individual debtor will lose a portion of his or her discharge under § 523(a)(2)(A) even in the absence of making a misrepresentation to a creditor in order to obtain money or property. The issue is much broader and far more consequential to individual debtors engaged in small and mid-sized business. Instead, Petitioner seeks to enlarge the non-discharge provisions of § 523(a)(2)(A) to now include a transferee of a fraudulent conveyance, (Pet. Br. 14) even in the absence of justifiable reliance and a misrepresentation made to the creditor, and even where the original debt was not "obtained by fraud."

This Court ruled over 140 years ago, that a transferee of a constructively fraudulent conveyance *does not lose* his or her discharge because of their involvement in the transfer. *Neal v. Clark*, 95 U.S. 704 (1877). In 1995 this Court held that § 523(a)(2)(A) requires a showing of justifiable reliance on an alleged misrepresentation in order to warrant a loss of a discharge. *Field v. Mans*, 516 U.S. 59 (1995) Petitioner now seeks to establish the opposite rule—namely, that a debtor transferee can lose his discharge even where there is neither an actual misrepresentation by the debtor nor any reliance by the creditor.

The change in the law sought by Petitioner is based on a world view of the bankruptcy population as

inherently untrustworthy. Here they posit the paradigm of one who has allegedly "drained" his company of assets and then filed for bankruptcy. One amicus writes that the paradigm is illustrated by the Bernard Madoff Ponzi scheme. Law Prof. Amici Br. 29. Amici for Petitioner argue that the Fifth Circuit ruling "would reward the dishonest—especially the more ingeniously dishonest." Law Prof. Amici Br. 2. Others argue that debtors could exploit a loophole without reversal of the Fifth Circuit.

Yet, Petitioner's brief cites no empirical evidence to suggest that there is widespread misconduct by business debtors nor that the subset of the "ingeniously dishonest" contains more than a few Bernie Madoffs.[4] A more accurate view, however, of exactly who are the Chapter 7 debtors, and how they would be effected by the change in the law is found in empirical evidence. The number of Chapter 7 debtors who may be considered to be "self-employed" (and hence more accurately thought of as "business" debtors) is approximately 72,000 per year or roughly 14% of all Chapter 7 bankruptcy cases.[5] These Chapter 7 cases are typically the result of business stress and failure by entrepreneurial debtors, who stand to lose many years of future earnings by the rule urged here.[6]

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[4] Under § 727, certain dishonest debtors may be denied a discharge with respect to all debts. Bernie Madoff would have been denied a discharge under § 727(a)(2) on the basis that he transferred property with the intent to hinder, delay, or defraud his creditors.

[5] *Id.* at 112. The number of 72,000 is based on applying 14% to approximately 516,357 Chapter 7 cases filed in 2015. http://www.abi.org/newsroom/bankruptcy-statistics.

[6] "For the median self-employed debtor, it would take almost five years worth of income to retire the outstanding debts."

The change sought by the Petitioner will create unjustified and unnecessary leverage in favor of creditors against the self-employed debtor, for whom transfers between family and business occurs daily, through salaries and payment of normal expenses for living. Every constructive fraudulent conveyance will too readily become recast as "actual fraud" and the basis for an exception to discharge.[7] The targets of the change in the law will be those least able to defend against over-zealous creditors who will always see actual fraud. Thus, while the world may have but one Bernie Madoff, this Court has noted a wider universe of aggressive lenders who sometimes ensnare consumers through questionable lending practices.[8] It was for this reason that the Court spoke of "moderating" the burden on Chapter 7 debtors who seek a discharge. *Field v. Mans, supra* at 76.

The plain meaning of the Code does not justify the rule sought by Petitioner. The statutory phrase, "obtained by" limits the non-discharge rule to fraud at the inception of a transaction, that is, when the debt is first obtained. A discharge should be subject to challenge only where there is a causal nexus between

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Robert M. Lawless, *Striking Out on their Own: The Self Employed in Bankruptcy*, in BROKE: HOW DEBT BANKRUPTS THE MIDDLE CLASS, (Katherine Porter ed, 2012), 111.

[7] Constructively fraudulent conveyances can include certain transfers without regard to intent made while the debtor was insolvent (i.e., debts were greater than assets).

[8] This Court has noted that creditors sometimes engage in conduct which can encourage fraud in order to provide a later argument for a barrier to a discharge. *See Field v. Mans*, supra, noting the "practices of consumer finance companies which sometimes have encouraged such falsity by their borrowers for the very purpose of insulating their own claims of discharge." *Id.* at 77, n.13.

the alleged fraud and the breach of the original credit transaction. The notion of "actual fraud" embraces the traditional notion of "proximate cause." *See Archer v. Warner*, 538 U.S. 314 (2003)(Thomas, J., dissenting). And, in *Field v. Mans*, 516 U.S. at 66, this Court held that § 523(a)(2) applies when the debt "follows" the alleged fraud. The Seventh Circuit rule in *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000), upon which Petitioner now relies, is to the contrary.

The Code currently provides ample protection for creditors who have been injured through fraudulent conveyances of assets. Few would dispute that § 523(a)(6) fully addresses the real concern of creditors in the position of Husky. *See McClellan v. Cantrell, supra.* at 896. ("The provision that most aptly describes the situation here is § 523(a)(6)")(Ripple, J. concurring). The rule advanced by the Petitioner will render § 523(a)(6) redundant, and thus there is yet another reason why there is no need for the expansion sought by Petitioner.

Reversal of the Fifth Circuit decision will reach into the corporate world as well, and will impair bedrock principles of corporate separateness. Reversal will make it more likely that aggressive creditors will seek to impose liability on owners of corporations and business entities even where the standard for piercing the corporate veil cannot be met. And, the rule advocated by the Petitioner is contrary to sound bankruptcy and economic policy. This Court has long underscored the critical importance of the discharge to the individual debtor's fresh start. *Williams v. United States Fidelity & Guaranty Co.*, 236 U.S. 549 (1915). This Court confirmed in *Neal v. Clark* that narrowly construing exceptions to discharge is "consonant with equity and consistent with the object and intention of

Congress in enacting a general law by which honest citizens may be relieved from the burden of hopeless insolvency. A different construction would be inconsistent with the liberal spirit which pervades the entire bankruptcy system." *Neal, supra.*, 95 U.S. at 709. The rule advanced by Petitioners is contrary to this spirit and policy. The decision in the Fifth Circuit should be affirmed.

ARGUMENT

I. The Legal Standard for Nondischargeability of a Debt Under § 523(a)(2)(A) Should Retain the Requirement of a Misrepresentation That Induced the Credit Transaction.

A. Reversal of the Fifth Circuit Decision Will Needlessly Harm Self-Employed, Honest Debtors.

The central issue in this case is not simply whether the "actual fraud" bar to discharge under § 523(a)(2)(A) of the Bankruptcy Code applies only where the debtor has made a false representation to obtain credit. Instead, the critical issue is whether debts will become nondischargeable under circumstances where Congress did not intend for the discharge to be lost and where bankruptcy policy favors protecting the discharge. The rule of law sought by Petitioner here will be unduly punitive, and will encourage creditors to pursue owners of small businesses who receive pre-bankruptcy transfers in the hopes of manufacturing a case for "actual fraud." *See Field v. Mans*, 516 U.S. at 77, n. 13.

In *Field v. Mans*, this Court held that denial of a discharge under § 523(a)(2)(A) requires a showing of

causation and justifiable reliance, in large measure because of the use of the phrase "obtained by . . . actual fraud." Petitioner seeks to have this Court hold that § 523(a)(2) prevents an individual debtor from obtaining a discharge even in the absence of (a) any misrepresentation to the creditor; (b) any showing of actual reliance; (c) any showing that fraud was used to obtain the initial credit and, (d) even in those cases where the alleged "fraud" occurs years after the initial credit transaction, such as where the debtor is only the transferee of a fraudulent conveyance.[9]

The outcome urged by Petitioner will expand the scope of nondischargeable debts significantly, and injure the typical Chapter 7 debtor who was self-employed, as well as transferees from larger companies. The first key point is that the transfers that may become labelled as "constructively fraudulent" under the Bankruptcy Code are the same transfers that are the daily stuff of a small to medium sized business. Small to mid-sized companies, owned by an individual or a family, are constantly transferring funds from the company to the individual; this is how such owners make a living. Cash flow is received, and then distributed to owners. The line between family and

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[9] Ritz himself is alleged to have directed the transfer to seven companies that he owned and controlled; he was not himself a direct transferee, but the owner of the transferee. However, the Petitioner has framed this case as whether "actual fraud refers to any intentional fraud, and includes a transferee's participation in a transfer scheme that he knows is intended to defraud creditors." Pet. Br. 14-15. And, as noted throughout, Petitioner argues case law dealing with transferee liability, including *Neal*. *Id*. at 15. Because he was not a transferee it is unclear how he could have "obtained" any property as a result of the fraud.

business is imperceptible at times.[10] When a business entity experiences financial difficulty, owners still distribute funds to themselves. Such distributions, typically including salaries, are honest and legitimate but in the eyes of a creditor seeking to challenge a discharge, the allegation that the transferee knew the entity was insolvent and thus was "draining" the company by making payments, is easy to make, especially in hindsight, costly to defend, and will tilt the litigation strategy in favor of creditors seeking to extract settlements from smaller debtors. Litigation will increase and the result may be unjust and unfair.

The second key point is that while the paradigm of the "Bernie Madoff" case is rare, the number of business bankruptcies involving Chapter 7 debtors is large. "Most business bankruptcy cases filed in the United States involve small and middle-market enterprises. These businesses include family owned businesses, entrepreneurial ventures and startup companies."[11] Small and middle market companies are prone to failure and "can be among the hardest hit in economic downturns." *Id.* Those who enter bankruptcy owning their own business, (including the "self-employed"), are in the most vulnerable position. ("If the 1.5 million bankruptcy cases filed each year come

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[10] As one scholar framed it, "For most every self-employed person in bankruptcy, it makes no sense to talk of a business with a separate existence apart from its owner. The owner's financial life is the business' financial life and vice versa . . . Ninety-six percent [of business debtors] report some use of personal financial resources to support the business . . ." Robert M. Lawless, *Striking Out on their Own: The Self-Employed in Bankruptcy*, BROKE: HOW DEBT BANKRUPTS THE MIDDLE CLASS, *supra* at 109.

[11] American Bankruptcy Institute, Commission to Study the Reform of Chapter 11, 2012-2014 Final Report and Recommendations (2014), 276 ("ABI Report").

from people at the bottom of the financial heap, the self-employed are the bottom of the bottom.")[12]

Third, the failure of the mid-sized business entity often leads directly to the individual Chapter 7 bankruptcy filing. The business entity failure engulfs the business owners—those who become Chapter 7 debtors. "The changes in the composition of small businesses in bankruptcy may also suggest an ever-tighter link between the failure of a small business and the failure of its owner."[13] One commentator writes that, "one in seven individuals in the bankruptcy system is a struggling entrepreneur."[14] These self-employed owners who need to consider bankruptcy protection will be greatly disadvantaged by a change in existing law.

The determination that a debt is nondischargeable for the business Chapter 7 debtor has severe consequences. A detailed study of the relationship between small businesses entrepreneurs and bankruptcy shows that, unlike their large corporate counterparts, these debtors' personal assets are exposed to creditors; "[i]t is only the debtor's personal assets, such as the house, the car and the checking account, that are the target of creditor actions."[15]

Fourth, the number of cases that may be affected by the change sought by Petitioner is large. Research discloses that about one in seven Chapter 7 debtors are "self-employed" or business debtors. In 2015 there

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[12] Robert Lawless, *Striking Out on their Own*, *supra* at 109.

[13] Robert Lawless and Elizabeth Warren, *supra* at 791.

[14] *Id.* at 786.

[15] *Id.* at 792. This would pertain unless the specific asset was exempt under applicable law. *See* § 522(b).

were 516,357 Chapter 7 cases, and thus approximately 72,000 Chapter 7 debtors could be affected by the change sought by the Petitioner.[16]

Fifth, Petitioner offers neither documented nor empirical evidence of wide spread dishonesty by the typical Chapter 7 business debtor. The empirical evidence does document the financial distress at the very "bottom of the bottom." The classic example that deserves focus here is not Mr. Ritz. Instead, the more typical situation is where a debt is obtained honestly by a small or medium size company that is family or farm owned.

Honest transfers may be easily alleged to be improper. This Court itself noted that sometimes creditors themselves engineer this result. *Field v. Mans*, *supra*. at 77, n.13. The badges of fraud make the transition from insider transfer to "actual fraud" easy to allege. If the Petitioner succeeds in this case, creditors are almost certain to use the enlarged definition of § 523(a)(2) to enslave these business owners with debt that they cannot discharge.[17] Creditors will be even more likely to argue that the knowing receipt of a transfer of funds years after the credit was obtained is sufficient "actual fraud" to deny individuals a discharge.

This case illustrates how a lack of documented financial harm to a creditor can be presented in a

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[16] *Id*. at 793.

[17] "If the median self-employed person devoted all income to debt repayment—forgoing food, clothing, and all other necessities of life- it would still take that five years of work before all outstanding debts were repaid. When they arrive in bankruptcy, the self-employed are in a deep financial hole." Lawless, *supra* at 111.

prejudicial light, even if lacking in substance. In this case, the Petitioner's brief repeatedly identifies Ritz as one who "drained" the estate of his company, and thus is unworthy of receiving a discharge. Indeed, the "Question Presented" asks this Court to address a "fraudulent transfer scheme that was actually intended to cheat a creditor." Pet Br. i.[18] Yet, the facts presented do not show that the "scheme" diminished the assets in the Ritz' bankruptcy estate. According to Petitioner, Ritz transferred "over a million dollars" from Chrysalis to "seven other entities that he [Ritz] owned and controlled." Pet. Br. 6. Ritz filed for bankruptcy sometime thereafter. *Id.* At the time of his filing, the value he transferred to his owned entities (the same $1.0 million) would be part of his personal bankruptcy estate as the "equity value" in these entities. Accordingly, there should have been no loss of value to Ritz' creditors. Petitioner fails to explain how these internal transfers injured creditors since the value remained within Ritz' entities, all of which are part of a Chapter 7 estate.

Perhaps for this reason, or others, all three courts below found that "Husky failed to meet its burden to show that Ritz intended to willfully and maliciously injure Husky, as required by § 523(a)(6)." Petitioner Br. 7, n.3. Further, the Court of Appeals affirmed the bankruptcy court's finding that there was "scant evidence in the record indicating either that Ritz made the[] transfer with the intent to harm Husky, or that harm to Husky was substantially certain due to Ritz'

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[18] Significantly, Husky was not found to be a creditor of Ritz, at least not for the purchases made by Chrysalis. The claim for non-payment was a liability of Chrysalis. The bankruptcy court found no basis to pierce the corporate veil and make that claim a debt owed by Ritz. *In re Ritz*, 787 F.2d at 315.

action." *Husky International v. Ritz*, 787 F.3d 312, 321 (5th Cir. 2015). Thus, the "Question Presented" cannot truly be answered on this record, since it seems doubtful there was an "actual intent to cheat" as suggested by Petitioner. Pet. Br. at i. For these reasons alone, the Fifth Circuit's decision should be affirmed.

This, then, is not a case about wide spread fraud, ingenious debtors or Bernie Madoff. This case seeks a change in the law that will target the typical Chapter 7 business owner. The rule will be harmful, severe, and as noted below, unnecessary. The rule advanced by the Petitioner will have the direct effect of targeting for discharge litigation the owners of small and medium sized businesses, and will do little or nothing to address purported issues with "dishonest debtors."

B. Reversal of the Fifth Circuit Decision Will Harm Executives and Employees of All Businesses; Affect Chapter 11 Cases, and Impair the Important Goal of Corporate Separateness.

Beyond causing needless loss to the self-employed Chapter 7 debtor, it is critical to note that a similar detrimental outcome will occur in Chapter 11 cases, especially where the executives or owners of a company, private or public, or forced to file an individual bankruptcy case when the entity itself fails. An individual who files for protection under Chapter 11, 12 or 13, and seeks a discharge, is subject to the limits of § 523(a)(2)(A). *See* § 523(a) referring to a discharge under § 1141, § 1228(b), and § 1328(b).

The threatened loss of a discharge in this context imperils the key notion of corporate separateness; "[L]imited liability is the rule, not the exception."

Anderson v. Abbott, 321 U.S. 349, 362 (1944). Entrepreneurs invest in entities, including public companies and limited liability companies, based in part on the legal assurance that they will be insulated from liability for the claims of the company. Based on "that assumption [of limited liability] large undertakings are rested, vast enterprises are launched, and huge sums of capital attracted." *Id.*

This Court has spoken to the issue of separateness. While fraud may sometimes permit piercing the corporate veil, the general rule is that the owners are not liable for the debts of the entity, just as the parent corporation is not liable for the debts of its subsidiaries:

> It is a general principle of corporate law deeply "ingrained in our economic and legal systems" that a parent corporation (so-called because of control through ownership of another corporation's stock) is not liable for the acts of its subsidiaries. Douglas & Shanks, *Insulation from Liability Through Subsidiary Corporations*, 39 YALE L.J. 193 (1929); 1 W. Fletcher, Cyclopedia of Law of Private Corporations § 33, p. 568 (rev. ed. 1990) ("Neither does the mere fact that there exists a parent-subsidiary relationship between two corporations make the one liable for the torts of its affiliate").

United States v. Bestfoods, 524 U.S. 51, 61 (1998).

The Fifth Circuit decision is in accord with this notion of separateness, because it provides appropriate assurance that creditors are not given unfair leverage to penetrate the wall of separateness and hold owners, executives, officers and directors liable

for the debts of their entity under the guise of a "fraudulent conveyance," especially where no reliance has been shown.

The requirement for an actual representation under § 523(a)(2)(A) maintains the barriers between individuals and corporate entities, and aligns the bankruptcy outcome more with the common law, which does not impose liability in the absence of an affirmative showing that would permit piercing the corporate veil. Modern corporate law theory requires a high threshold showing to pierce the corporate entity and requires substantive showings well beyond mere receipt of a transfer during a period of distress. *See generally*, 191 Fletcher Cyc. Corp. § 41.30. This is particularly true in this kind of case, given that the bankruptcy court found that Husky had *not* made the requisite showing to pierce the corporate veil under Texas law.[19] Reversal of the Fifth Circuit decision would open a Pandora's box of consequences undercutting the limited liability principles that are the foundation of corporate law.

Corporate separateness could be weakened by a rule that imposes liability on bankruptcy debtors who received any kind of distribution, including ordinary compensation, while serving as a senior executive of a large company, or acting as a self-employed owner of a limited liability company. Many of these companies are thinly capitalized. They may hover in the zone of insolvency for years and still be viable, paying regular salaries to employees and officers. An economic shock may then force company and owner/executive into bankruptcy. Any insider transfers, including salaries, would open up the individual to a claim of a fraudulent

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[19] *In re Ritz*, *supra*, 787 F.2d at 315.

conveyance and a loss of a discharge in the individual case. This is nothing more than a back door effort to erode the theory of corporate separateness, which has long been a bedrock of American corporate law.

II. The Fifth Circuit Correctly Applied the Plain Meaning of Section 523(a)(2)(A).

A. The Fifth Circuit's Opinion Properly Applies the Holding in *Field* that the Debt Must Be "Obtained by" Fraud and thus the Credit Must "Follow" the Alleged Fraud.

Section 532(a)(2)(A) is properly read to mean, plainly, that in order to deny a debtor a discharge, there must be a showing that there was an actual misrepresentation made to the creditor, at the inception of the credit transaction, that is, when the credit or money was "obtained" and that there was justifiable reliance. The section bars from discharge "any debt . . . for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by . . . false pretenses, a false representation, or actual fraud." 11 U.S.C. § 523(a)(2)(A).

The key phrase is "obtained by." In *Field v. Mans*, 516 U.S. 59 (1995), this Court held that § 523(a)(2)(A) requires a showing of causation and justifiable reliance because of the use of the phrase "obtained by . . . actual fraud." ("No one, of course, doubts that some degree of reliance is required to satisfy the element of causation inherent in the phrase 'obtained by" . . .") *Id.* at 66.

More to the point, in *Field* this Court stated explicitly that § 523(a)(2) "applies expressly . . . when the debt *follows* a transfer of value or extension of

credit induced by falsity or fraud." *Id.* at 66 (emphasis added). Thus, the fraud must occur first, and *then* the extension of credit, (and hence the fraud is the cause of the debt) and not as here, the extension of credit first, and years later, some alleged misconduct.

Justice Ginsburg's concurring opinion in *Field* strongly intimated that if the fraud did not occur at the inception of the loan transaction, there was no liability under § 523(a)(2). At oral argument, Justice Ginsburg asked counsel what would happen if the debtor had transferred the property "without saying one word to the creditor." *Id.* at 79. In that case there would be neither a representation nor reliance at the time credit was extended, and hence the loan would not be "obtained by" fraud. Counsel answered that "I would agree with you, it would be dischargeable." *Id.*[20]

The notion that the debt must be obtained by fraud at the inception of the credit transaction in order to justify a challenge to discharge finds direct support in the opinions of Justices Thomas and Stevens, dissenting, in *Archer v. Warner*, 538 U.S. 314 (2003). There they stated that there must be a causal nexus between

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[20] Justice Ginsburg stated that a causation issue was "still open for determination on remand . . . Was the debt in question, as the statute expressly requires, obtained by the alleged fraud." *Id.* at 78. Justice Ginsburg did not express an opinion on the appropriate resolution of the unsettled causation ("obtained by") issue, but the exchange at oral argument suggests it was a determining issue. She noted that it had been raised below, and the same is true here. Ritz argued that the loan was not obtained by fraud, but the Fifth Circuit stated it did not need to reach this alternative argument. *Husky International Electronics, Inc. v. Ritz (In re Ritz)*, 787 F.3d 312, 316, n.4 (5th Cir. 2015).

the fraud and the debt, which arises from the requirement that the debt be "obtained" by fraud and gives meaning to the inherent limit in all definitions of fraud of "proximate cause."

> In interpreting this provision, the Court has recognized that, in order for a creditor to establish that a debt is not dischargeable, he must demonstrate that there is a causal nexus between the fraud and the debt. See *Cohen v. de la Cruz*, 523 U.S. 213, 218, 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998) (describing § 523(a)(2)(A) as barring discharge of debts "'resulting from'" or "'traceable to'" fraud (quoting *Field v. Mans*, 516 U.S. 59, 61, 64, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995))). Indeed, petitioners conceded at oral argument that the "obtained by" language of § 523(a)(2) requires a creditor to prove that a debtor's fraud is the proximate cause of the debt.

Archer v. Warner, 538 U.S. 314, 325-26 (2003).

Justices Thomas and Stevens correctly viewed the language of § 523(a)(2)(A) as containing the traditional notion of "proximate cause" in understanding the meaning of fraud. Thus, certain intervening causes "are sufficient to sever the causal nexus and cut off all liability." *Id.* at 326. The conduct of a transferee, years after a credit transaction, may have no relationship to the failure of an entity to repay a loan.

Decisions from the lower courts also support the view that a debt does not become nondischargeable under § 523(a)(2) through a post-transaction fraud. For example, in *In re Blake*, No. 13-20982 (ASD), 2015 WL 5601346, *3 (Bankr. D. Conn. Mar. 9, 2015) the

court held that nondischargeability is only permitted where the fraud occurred "at the time of, and has been the methodology by which the money, property or services were obtained." Further, it elaborated that fraud must occur at the "inception:"

> That is to say, the "funds themselves must have been obtained by fraud in the inception." . . . Misrepresentations that are made subsequent to the creation of the debt "have no effect upon the dischargeability of a debt, since the false representation could not have been the creditor's reason for the extension of credit." (citations omitted).

Id.

This case presents an opportunity for this Court to clarify the ruling in *Field v. Mans* on the full import of the word "obtained" and its relationship to the notion of causation. Justice Ginsburg noted that the issue of the full import of "obtained" was not resolved in *Field*. ("I express no opinion on the appropriate resolution of the unsettled causation ("obtained by") issue.") 516 U.S. at 79. While both the majority and Justice Ginsburg strongly intimated that "obtained by" was a significant limit, neither signaled a full resolution. This case now presents that opportunity.

B. Section 523(a)(2) Should Not be Read As Encompassing All Common Law Fraud.

Petitioner argues that § 523(a)(2) embraces the entire universe of common law fraud. This misses the structural and textual limits that are contained within this section. First, the interpretation of "actual fraud" in § 523(a)(2) must be based on the rule of construction that the surrounding text and provisions provide key

illumination into the meaning. ("It is a familiar rule in the interpretation of written instruments and statutes that 'a passage will be best interpreted by reference to that which precedes and follows it.") *Neal v. Clark*, *supra* at 709.[21] The term "actual fraud" in this section relates to what precedes it, and does not open up the entire universe of fraud. That is why *Field v. Mans* requires an actual representation to a creditor, and did not intimate that the phrase "actual fraud" was an independent and unrelated basis for loss of discharge. Some misrepresentations are *not* fraud, but are negligent, and thus the phrase "actual fraud" serves to limit the kinds of misrepresentations that do bar a discharge, but does not necessarily signal that § 523(a)(2) embraces the entirety of the common law meaning of fraud.

Second, related to this, the insertion of an "or" between misrepresentation and "actual fraud" does not suggest that actual fraud is entirely independent of what precedes it. "Actual fraud" limits misrepresentation, but does not create a wholly new category. "Or" is not necessarily the signal that this is a separate category, unrelated to the language that precedes it.[22] The Fifth Circuit noted that COLLIER ON BANKRUPTCY supported the notion that this phrase did not suggest

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[21] Context is also key to statutory interpretation. "The plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole." *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997).

[22] *See* discussion in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065, 2068 (2012) where Justice Scalia said that such an insistence on the meaning of "or" was being hyper-literal. "The debtors' reading of § 1129(b)(2)(A), under which clause (iii) permits precisely what clause (ii) proscribes, is hyperliteral and contrary to common sense."

a separate category of non-dischargeability.[23] This Court stated as much in *Field* where it said that some misrepresentations may be innocent and not evidence fraud. 516 U.S. at 68, n.7. Thus the addition of "actual fraud" limited "misrepresentation." It did not expand it into unrelated forms of fraud or strip out proximate cause and causality.

Third, even if the term "actual fraud" embraces the common law concept of the tort of fraud, that concept is itself tempered and limited by notions of proximate cause. "The Court has explained that, '[a]t bottom, the notion of proximate cause reflects 'ideas of what justice demands, or what is administratively possible and convenient.'" And equally key here, "What we do mean by the word 'proximate' is, that because of convenience of public policy, of a rough sense of justice, the law arbitrarily declines to trace a series of events beyond a certain point.'" *Archer v. Warner*, *supra*, at 538 U.S. at 326, citing *Palsgraf v. Long Island R.R. Co.*, 248 N.Y. 339, 352, 162 N.E. 99, 103 (1928) (Stevens, J. and Thomas J., dissenting). Here, there are limitless intervening events which caused Chrysalis not to be able to repay Husky; the transfer of funds to another entity, years later, does not satisfy this common law notion of proximate cause.

The Petitioner's argument that there is no need for an actual representation eliminates the requirement

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[23] The Fifth Circuit also acknowledged this: "Here, although "actual fraud" was added to the statute in 1978, some have suggested that Congress did not intend to create a separate basis for dischargeability – but rather intended only to codify 'the limited scope of the fraud exception to mean actual or positive fraud rather than fraud implied by law," citing to Alan N. Resnick & Henry J. Sommer, Collier on Bankruptcy, ¶ 523.08[01][e] (16th ed. 2014). 787 F.3d at 320.

that the debt be one "obtained" by fraud, and in so doing, eliminates causation and proximate cause. The requirement that the debt be "obtained" by fraud, is closely tied to the well-developed law in this area that requires a representation to a creditor and a causal connection and justifiable reliance. The interpretation urged by Petitioner would embrace all conduct by all persons at any time, regardless of how the loan was obtained, and regardless of any reliance. This would of course effect a sea change in the law, a change unwarranted by the absence of any congressional intent to do so.

C. The Seventh Circuit Decision in McClellan v. Cantrell Incorrectly Ignored the Requirement for a Misrepresentation.

Petitioner urges this Court to follow the contrary rule announced by Judge Posner writing for the Seventh Circuit in *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000). The Seventh Circuit held that § 523(a)(2) "is not limited to misrepresentations and misleading omissions" but includes "deliberate fraudulent-transfer schemes, 217 F.3d at 893." (Pet. Br. 13). The First Circuit, argues Petitioner, follows *McClellan* holding that actual fraud "includes knowing receipt of a fraudulent conveyance" designed to hinder, delay or defraud creditors. 791 F.3d 214, 225 (1st Cir. 2015)." Pet Br. 13, citing *In re Lawson*.

Judge Posner stated that there was no authority on point and that *Field* "has nothing to do with this case." *Id.* at 892. In order to get around the absence of any fraud when the debt was incurred, he constructed a "second debt" theory. *Id.* at 895. This second debt is not the credit transaction, but the obligation that

arises as a matter of law when one is liable under a theory of a fraudulent conveyance. *Id.*

The notion that the fraudulent conveyance gives rise to a separate debt or claim was rejected by the Ninth Circuit in *In re Saylor*, 108 F.3d 219, 221 (9th Cir. 1997). "Quarre's claim that he possesses a property interest in the fraudulent transfer remedies provided by state law does not fit within the definitions of either "debt" or "property" for purposes of section 523(a)(6), and runs counter to the long-standing principle that exceptions to dischargeability are to be narrowly construed."[24]

The problem with the *McClellan* analysis is that it simply reads too much out of the Code. Instead of adhering to the language of § 523(a)(2)(A) *McClellan* creates a broad barrier to discharge any time any debtor receives any property based on any kind of common law fraud. The context of § 523(a)(2) however evidences a narrower Congressional intent. Had this view of "actual fraud" been intended, then none of the other text in § 523(a)(2) would have been necessary, thus rendering most of the section superfluous.

Petitioner relies on *Neal* and argues that "*Neal* made clear that receiving a fraudulent transfer, with intent to commit a fraud or to help the transferor in doing so, makes the transferee liable for actual fraud. That is so even through the transferee's fraud involves no misrepresentation whatsoever." Pet. Br. 15.

The Court in *Neal* was not asked to address, and did not address, the question of whether transferee liability can arise where there is a showing of actual

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[24] Although this case arose in the context of a debtor as transferor, the logic is the same when dealing with a transferee.

fraud, nor the level of actual fraud, nor the legal standard to show such fraud. Even Judge Posner noted that no appellate decision had yet addressed the type of fraud that comes within the exception for "actual fraud" in the discharge context. *McClellan*, *supra* at 892.

Neal is an important case, but not for the reasons cited by Petitioner. What is important about *Neal* was this Court's insistence that in the absence of actual fraud, there is no rationale for considering a loss of the discharge. Further, the kind of fraud of concern to the Court was "associated directly with debts created by embezzlement." *Id.* at 709. The fraud referred to in that section means positive fraud, or fraud in fact, involving moral turpitude or intentional wrong, as does embezzlement . . ." *Id.* The standard of fraud was high, and your amicus urges this Court not to suggest any erosion in this high standard.

D. Section 523(a)(6) Amply Protects Creditors from the Kind of Harm Envisioned in this Case. Reversal would render § 523(a)(6) superfluous.

Circuit Judge Ripple in *McClellan*, concurring, correctly stated that § 523(a)(6) was the "proper avenue of relief in favor of an awkward and ill-fitting one." *Id.* at 896. We submit that Judge Ripple's concurrence correctly identifies the true remedy for those in the position of Husky, and that § 523(a)(2) simply does not pertain.

Other courts have correctly noted that § 523(a)(6) provides adequate protection for creditors who are injured by torts and seek to challenge a debtor's discharge.

> We thus note that in the exceptions to discharge articulated in § 523, Congress provided protection for creditors injured by the torts of bankrupt debtors in subsection (a)(6), which excepts from discharge a debt incurred as a result of the debtor's "willful and malicious injury" to the creditor or her property. It would be unnecessary for subsection (a)(2)(A) also to provide relief for judgment creditors injured in tort.

In re Gonsalves, 519 B.R. 466, 473 (Bankr. D. Md. 2014).

Section 523(a)(6) embraces a more equitable standard for loss of discharge, because it requires a showing of a "willful and malicious injury by the debtor to another or to the property of another entity." This Court held in *Kawaauhau v. Geiger*, 523 U.S. 57 (1998) that this requires a showing that the actor intended "the consequences of an act, not simply the act itself." *Id.* at 61-62. One court has held that this means a discharge can only be lost if there is an "objective substantial certainty of harm or a subjective motive to cause harm." *Miller v. J.D. Abrams, Inc. (In re Miller)*, 156 F.3d 598, 606 (5th Cir. 2014).

Conversely, under the rule sought by the Petitioner, a nondischargeable debt could be predicated on a presumption of fraud alone (e.g., a "badge of fraud"), without any evidence of willful or malicious conduct. These badges of fraud may be less rigorous than the standard of willful or malicious and may involve nothing more than a transfer to an insider.[25] This is

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[25] Creditors may seek to bar a discharge based on a presumption of fraud, that is, the through the use of badges of fraud. A "badge of fraud" is a presumption that may provide the elements

particularly pernicious for the self-employed Chapter 7 debtor, since the debtor's source of livelihood frequently depends on routine transfers from the entity to the "insider."

Alternatively, some might argue that § 523(a)(6)'s requirement of willful and malicious requires the same showing of intent as "actual fraud." It bears noting that the courts below found that this case did not satisfy the standard of "willful and malicious." Petitioner Br. 7, n.3. And there was, as noted, "scant" evidence of an actual intent to harm.[26] If § 523(a)(6)'s requirement for "willful and malicious" is meant to be the same standard as "actual fraud" under § 523(a)(2), then the Fifth Circuit's decision should be affirmed on the basis that there was no showing of actual fraud, and indeed, no basis for this appeal.

E. Sound Bankruptcy Policy Dictates Against Further Expansion of Debts that are Nondischargeable.

It is a long standing rule of construction that exceptions to dischargeability are narrowly construed. *Fezler v. Davis (In re Davis)*, 194 F.3d 570, 573 (5th Cir. 1999). This rule of construction is reflective of a broader policy that correctly sees the economic and

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of fraud. Transfers to an insider along with some other evidence of intent to hinder or delay may be sufficient. *See* Edward S. Weisfelner, ADVANCED FRAUDULENT TRANSFERS, 59 (ABI, 2014). If so, creditors might then argue that "actual fraud" under § 523(a)(2)(A) could be established by a presumption, whereas the current version of the code requires willful and malicious tort injury under § 523(a)(6). There is thus a potential for conflicting standards of proof.

[26] *Husky International Electronics, Inc. v. Ritz*, 787 F.3d 312, 321 (5th Cir. 2015).

social function of discharge as serving two goals; protecting the debtor and allowing him to become a more productive economic actor in our society, and legal symmetry that treats the individual debtor with similar rights and outcomes as the corporate debtor.

Under the rule sought by Petitioner, individual debtors may be obligated to spend much of their economic life paying for a loan transaction in which they had no involvement, and where their liability may have been grounded only on a presumption of fraud. The insistence on having an "actual representation" protects against this outcome, and is the correct result here.

CONCLUSION

For the foregoing reasons, amicus requests that the decision of the Fifth Circuit be affirmed.

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